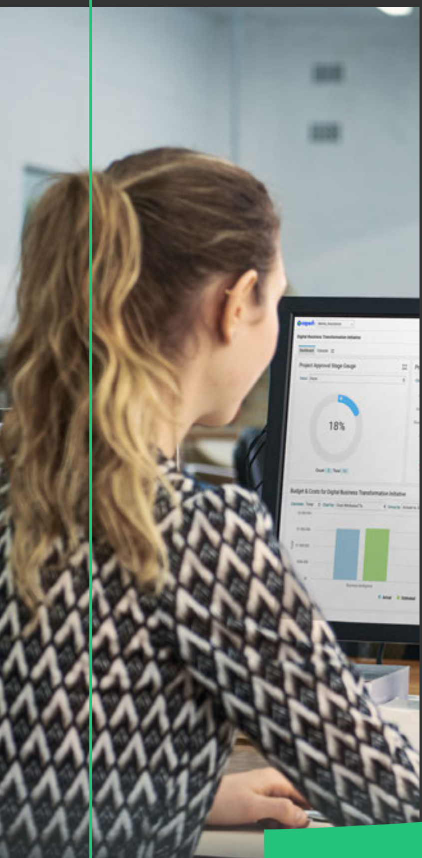
AUSTRALIAN
BUSINESS
GROWTH
FUND

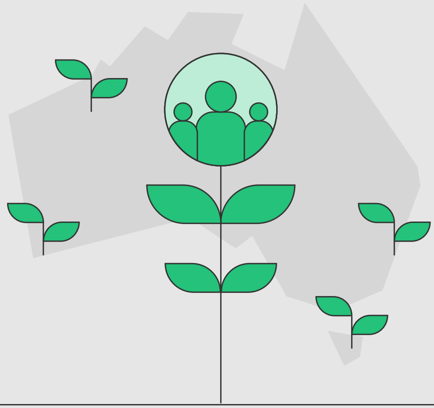


2024

POWERING THE GROWTH ECONOMY

At a glance

The Growth Economy consists of Australian businesses that have established operations and between $2 million and $100 million in revenue.



The Growth Economy can turbocharge Australia's economic prosperity.

Around 164,000 innovative small-medium businesses have the potential to underwrite a new era of economic growth and prosperity, and build sovereign capability to ensure the nation's security. For the first time, the number of Growth Economy businesses (with revenues of between $2 million and $100 million, more than two years of operations, and headquartered in Australia) has been identified. They comprise 6% of all companies but account for 42% of all employment, contribute a quarter of Australia's total economic output and account for nearly 50% of all research and development (R&D) spend in Australia.

Growth Economy businesses are the engine room of the economy.

Not only is the Growth Economy a major contributor to the broader Australian economy, these businesses are punching above their weight. Their growth is outstripping the overall economy with a compound annual revenue growth rate of 5.7% (FY18 – 22), compared to the rest of the economy at 4.3%. This growth is even more evident in jobs numbers, with Growth Economy businesses achieving 14% growth in employment (FY20 – 22), almost double the employment growth of larger businesses (8.0%) – and nearly five times the employment growth of smaller, micro businesses (3.0%).

Access to funding is critical; the Growth Economy is predominantly funded by debt, while equity becomes more important as businesses scale.

Access to funding is a significant barrier to business growth, impacting 79% of Growth Economy businesses. Compared to Organisation for Economic Co-operation and Development (OECD) countries, the funding landscape for Australian small-medium businesses is dominated by debt with limited access to growth capital and venture capital (247 times debt to growth and venture capital). Half of Growth Economy businesses rely on debt funding, regardless of their size, and only a fifth of Growth Economy businesses have any form of equity funding. Equity becomes more important as businesses grow, with 34% of larger businesses (revenue between $20 million and $100 million) having some form of equity, compared to 12% of smaller businesses (revenue between $2 million and $20 million).

Growth Economy businesses are seeking more external equity funding than they receive, equating to a $38 billion funding gap.

Private equity funds under management (FUM) in Australia has reached a record $65.5 billion. However, the vast majority has been used for major recapitalisations and large buyouts, with just 2% of private equity and 0.4% of venture capital funding being used for growth capital. While 35% of Growth Economy businesses sought external equity funding in the past three years, 53% were unsuccessful in securing this equity. Calculation of the external equity funding gap in the Growth Economy reveals a $38 billion gap.

Narrowing the equity funding gap will drive stronger and long-term economic outcomes.

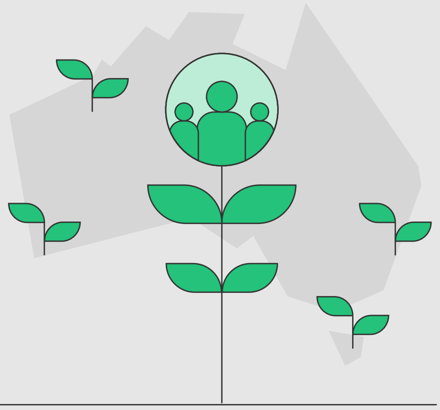
Growth Economy businesses estimate a 24.5% increase in revenue growth if they could access adequate equity funding. These businesses are critical in delivering government priorities to build sovereign capabilities as they disproportionately operate in segments outlined by the National Reconstruction Fund (NRF). Economic modelling also demonstrates the positive long-term impact of narrowing the external equity funding gap across investment, employment, wages and household consumption.

A new type of equity funding is needed to narrow the equity funding gap.

Traditional investors haven't historically seen commercial value in investing in Growth Economy businesses. Likewise, Growth Economy businesses don't perceive value beyond the financing traditional investors provide; and they don't want to give up control of their business. Consequently, 90% of investment into Growth Economy businesses comes from family and friends, not institutional investors that have the expertise and connections businesses need to scale. The Australian Business Growth Fund (ABGF) was established through a unique public-private partnership and is based on a proven model from the United Kingdom and Canada. This model is designed to overcome the limitations of the traditional investment model and demonstrate the commercial viability of investing in Growth Economy businesses, so further investors will follow. Collectively, this can narrow the funding gap and strengthen economic prosperity for all Australians.

About the data

This report draws on research and analysis commissioned by the Australian Business Growth Fund (ABGF) to define Australia's 'Growth Economy' and quantify the external funding gap within this Growth Economy.



East&Partners was commissioned to conduct primary market research as outlined in **Appendix A**. Strategy& was commissioned to conduct analysis based on available data sources such as the Australian Taxation Office (ATO), Australian Bureau of Statistics (ABS), Pitchbook, and complemented with the primary research conducted by East&Partners. Strategy& was also commissioned to conduct economic modelling as outlined in **Appendix B**.

The details of this proprietary research and analysis forms the basis of this report and has been reviewed and approved by Strategy& and East&Partners.

This report also draws on insights from subject matter experts and publicly available reports. In these instances, the source is referenced, or a hyperlink provided.

For the purpose of this report, the Growth Economy is defined by a company's annual revenue, longevity and headquarter location. However, where this data is not available, businesses with between 5 – 199 employees have been used as a proxy for analysis of the Growth Economy.

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Letter of introduction

AUSTRALIAN BUSINESS GROWTH FUND

The Australian Business Growth Fund, ABGF, was established three years ago as the only purpose-built growth capital fund dedicated to the small-medium enterprise (SME) sector. It was created because the Federal Government and six leading banks recognised there was a significant gap in the market for founders of small-medium businesses to access externally sourced equity.

At the time of the Fund's establishment, the Reserve Bank of Australia, the Australian Small Business and Family Enterprise Ombudsman and the Productivity Commission had identified a clear gap in the market for patient, long-term growth equity capital for SMEs seeking equity investment of between A$5 million and A$15 million. Filling this gap is expected to realise further growth and development of the SME sector in Australia.

Over three years into our journey and towards the end of 2024, we have deployed over $180 million of capital into twelve businesses. More importantly, our mission goes beyond financial investment. Our team and extended talent network provide these businesses with the expertise and connections they need to navigate growth opportunities and challenges.

Given our progress to date, it is timely to re-validate the gap we were established to target. In doing this, we have defined that part of the SME segment that meets our Fund investment mandate and named it the "Growth Economy". We have investigated how the Growth Economy contributes to the broader Australian economy and the Federal Government's policy priorities by conducting a deep dive into the demand for growth capital from Growth Economy businesses. This uncovered barriers faced by these businesses in accessing growth capital.

We know the provision of growth capital will unlock the potential of Growth Economy businesses and help generate stronger economic outcomes. These businesses will also play a significant role in building Australian sovereign capabilities across manufacturing, defence and renewable technologies – key Commonwealth Government priorities. It is therefore critical that we understand the opportunity the Growth Economy presents, and what these businesses need to catalyse their growth.

We believe this is the most comprehensive and recent report that truly analyses the Growth Economy with such depth and breadth. The data within comes from interviews with over 3,500 businesses, detailed analysis of Australian Bureau of Statistics and Australian Taxation Office customised data sets, and robust economic modelling. The report provides compelling data into the size and contribution of the Growth Economy, the strong and growing demand for externally sourced equity, the limited supply of the right forms of external equity, the ramifications of this gap on business growth, and the profound positive impact these businesses can have on the broader economy should the equity funding gap be filled. This will be an important read for anyone interested in the success of SME businesses.

We strongly believe this is critically important information that needs to be shared broadly. We will be advocating for further investment into this segment to address the challenges and opportunities faced by Growth Economy businesses. We welcome your views and experiences on this important topic, so please reach out if you would like to discuss this with us further.

Anthony Healy
CEO and Managing Director
October 2024

Contents

ABGF Portfolio Company: DIY Blinds
Online window furnishings

SECTION 1

The Growth Economy drives Australia's economic prosperity

SECTION 1A

Introducing the Growth Economy

Small-medium enterprises (SMEs) are deeply embedded into Australia's economic and social fabric. It's easy to understand why. Australia has always been an entrepreneurial nation, driven by a spirit of independence and a 'can do' attitude. Nearly every Australian knows someone who is an entrepreneur or works for one.

SMEs play a key role in adding value across every sector of the economy. They bring innovative solutions to challenges like climate change, resource efficiency, and social cohesion, spreading this innovation throughout the cities and regions.

They are essential to Australia's competitiveness and prosperity, economic and technological sovereignty, and our resilience to external shocks. That SMEs are the "engine room" of the Australian economy is a fundamental economic reality that underpins our economic vitality.

George Orwell in *Animal Farm* suggests "**some are more equal than others,**" a saying that can be applied to small-medium businesses' contribution to Australia's economic growth and prosperity.

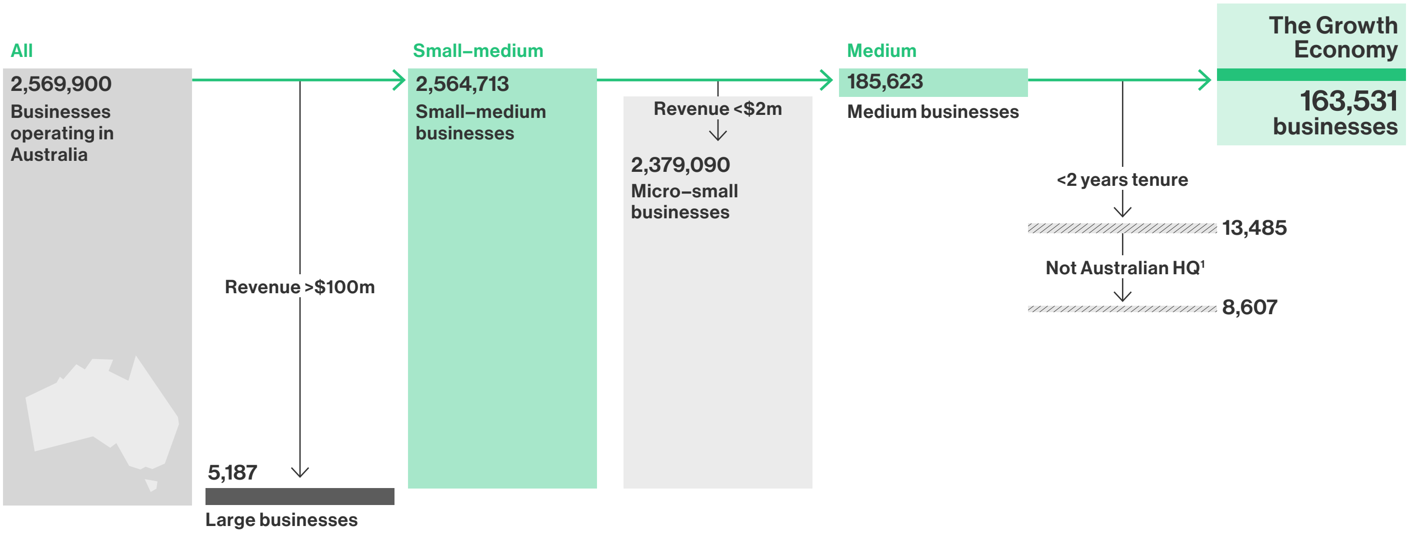
The composition of businesses in Australia can be broken down further to better understand where these contributions are coming from. The purpose of this report is to focus on the most meaningful business segment that is aligned with the investment mandate of the Australian Business Growth Fund (ABGF) and represents a majority of the growth in the SME economy. This report investigates their growth dynamics and capital requirements.

"Together small-medium businesses make up an incredible 97% of all Australian businesses. At last count they employ an estimated 5.2 million people, pay $194 billion in wages and salaries, and generate nearly $1.4 trillion in sales and services income. That takes innovation, dedication and hard work."

Julie Collins – Minister for Small Business, Federal Government
(Address to the COSBOA National Small Business Summit, Sydney, April 2024)

There are currently 2.6 million businesses operating in Australia. Of these, almost 164,000 represent the **Growth Economy** (see Figure 1A), accounting for 6% of all businesses in Australia.

FIGURE 1A: SIZING THE AUSTRALIAN GROWTH ECONOMY



Source: FY22 ABS customised data set, Strategy& analysis.

Large businesses

There are 5,187 large businesses operating in Australia with revenues exceeding $100 million.

Small to medium businesses

2,564,713 businesses are classified as small to medium.

Within this group the vast majority are **micro-small businesses** with revenues under $2 million.

Medium businesses

There are 185,623 medium-sized businesses.

These businesses are further filtered by excluding those:

- with less than two years of operational tenure (13,485 companies); and
- not headquartered in Australia (8,607 companies).

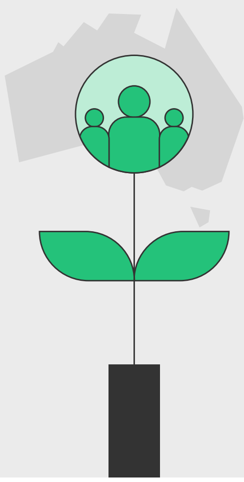
The Growth Economy[1] is defined by businesses that:

1— generate between $2 million and $100 million revenue;

2— have established operations (more than two years of operations);

3— are headquartered in Australia.

Using this definition, it will be shown that the Growth Economy is outperforming the broader economy in terms of revenue growth, employment growth contribution and research and development (R&D) spend. Critically, Growth Economy businesses can help turbocharge the economy and ensure sovereign capability targets are met.



[1]For the purposes of this report, the Growth Economy is defined by a companies revenue, tenure and headquarter location. However, where this data is not available, businesses with between 5 – 199 employees has been used as a proxy for analysis of the Growth Economy.

In Australia, despite representing a relatively small portion of all businesses, the number of Growth Economy businesses has expanded at a faster rate than other segments.

Increase in the number of businesses

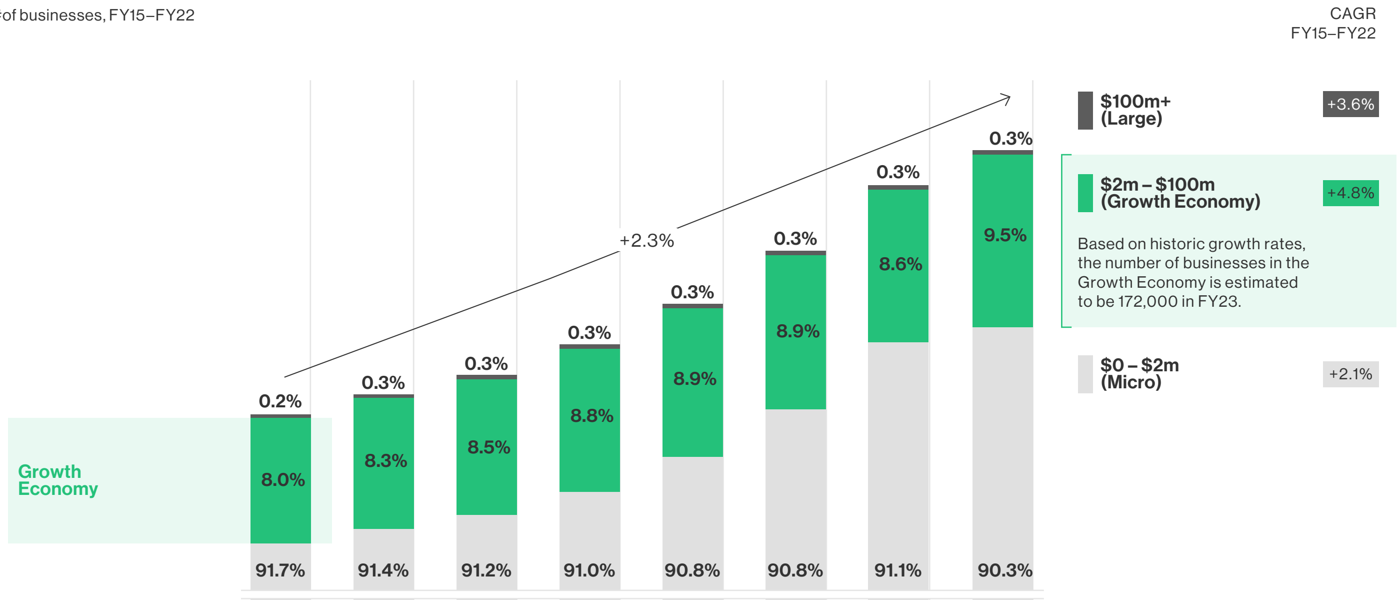
As shown in Figure 1B, since FY15, the number of these businesses has increased at a Compound Annual Growth Rate (CAGR) of 4.8%, surpassing the increase in the number of micro businesses (3.6%) and large businesses (2.1%).

Importantly, the Growth Economy has served as an incubator for transitioning companies into larger enterprises, with over 1,000 businesses growing their revenues beyond $100 million during this period. According to McKinsey, growth opportunities for SMEs in the mining sector have driven the disproportionately high rate at which Australia's SMEs scale up to larger companies – more than twice the average across the countries analysed by the consulting firm.

> **"44% of large Australian public companies in 2022 were micro, small or medium-sized enterprises (i.e. have 'scaled up') at some point since 2000."**
>
> *A microscope on small businesses: Spotting opportunities to boost productivity* (2024), McKinsey

FIGURE 1B: HISTORICAL GROWTH IN THE GROWTH ECONOMY

#of businesses, FY15–FY22



	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
# of Businesses	1,471,761	1,490,611	1,509,066	1,537,525	1,576,390	1,626,693	1,689,210	1,726,713
Large ($100m+)	3,605	3,766	3,797	3,915	4,149	4,320	4,303	4,617
Growth Economy ($2m – $100m)	118,084	123,906	128,514	135,149	141,152	145,050	145,293	163,531
Micro ($0m – $2m)	1,350,072	1,362,939	1,376,755	1,398,461	1,431,090	1,477,323	1,539,615	1,558,565

[1]This is based on the revenue filter reported by the ABS and assumption that 95% of the companies are headquartered in Australia.

Source: ATO 2015 – 2021, ABS customised data set, Strategy& analysis.

The increase in the number of Growth Economy businesses is not geographically consistent across Australia. As expected, major cities and larger states have the greatest number of businesses, but smaller states, cities and regions have the highest increase in the number of businesses.

Geographic increase in businesses

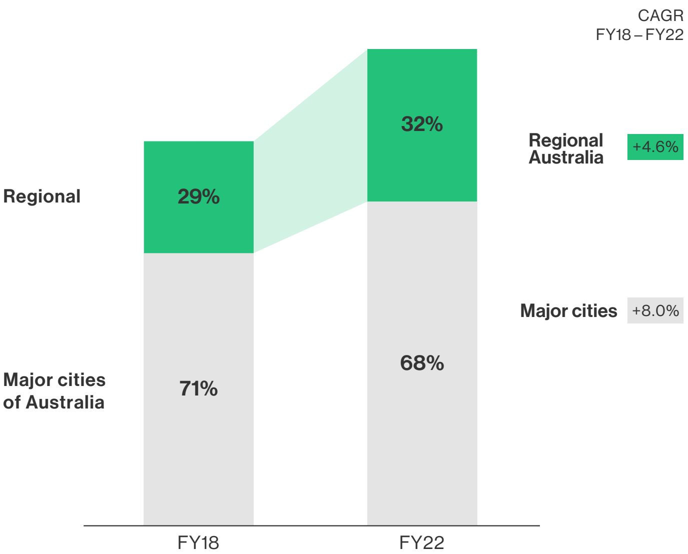
As Figure 1C shows, the number of Growth Economy businesses in regional Australia represented 29% of all Growth Economy businesses in FY18. This increased to 32% in FY22.

Given the increase in the total number of Growth Economy businesses during this time frame, the CAGR in the number of businesses in regional Australia is over double that of major cities.

FIGURE 1C: OVERVIEW OF SMES BY GEOGRAPHY

Number of Growth Economy businesses by region in Australia

%, FY18 and FY22



Source: ABS 'Economy and Industry', ABS 2021 Census Data, Strategy& analysis.

Regional Australia, with its rich resources and vibrant communities, is a significant part of the country's economic fabric and offers opportunities for investment that can drive aggregate growth and decentralise economic activity to reduce regional disparities. Emerging success stories across regional hubs highlight this trend.

For example, Tasmania and Queensland enjoy disproportionate growth in the number of businesses within these states, while individual regional towns across the country are thriving. Below are a handful of examples:

- **Launceston in Tasmania** has a rich history from the wool and tin industry of the 18th century. In FY23, the number of registered businesses grew by 7.2%, contributing 16.7% of Tasmania's employment and 15.6% of its economic value output across a diverse array of sectors.
- **Moreton Bay in Queensland** is the fastest growing economic region of South-East Queensland, most notable for its food and agribusiness sector, advanced manufacturing and thriving transport and logistics industries.
- **Wagga Wagga** is a major inland city in NSW with robust agricultural, health care, and manufacturing sectors. In FY23, there was a 4.5% increase in the number of registered businesses.
- **Lake Macquarie**, just north of Sydney, makes up 21% of the Hunter economy with an average of almost 2,000 new businesses starting in the area each year (between 2019 – 2022).
- **West Pilbara in Western Australia** is a product of the decades-long resources boom experiencing significant economic growth and a clear example of how strategic investment in regional Australia can stimulate overall economic expansion.

Collectively, the Growth Economy operates across a more diverse geographic landscape than large businesses and provides a greater contribution to the development of regional Australia.

SECTION 1B

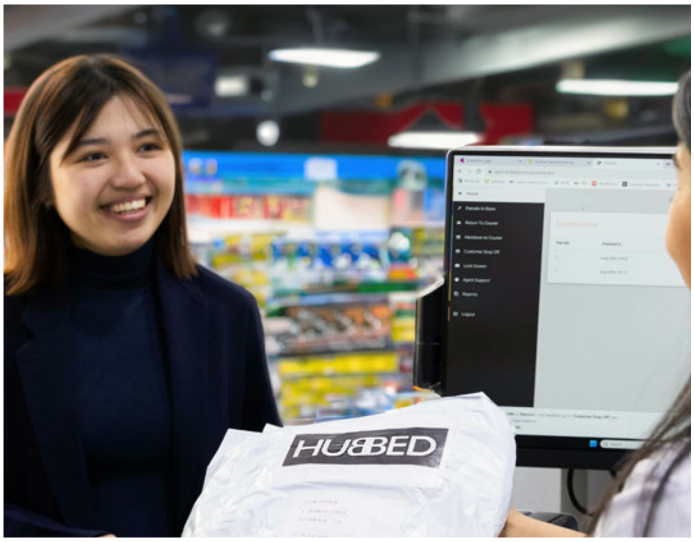
The economic impact of the Growth Economy

The Growth Economy is a powerhouse of the Australian economy, contributing significantly to the country's prosperity. This is particularly evident in terms of total economic output, revenue growth, R&D and job creation.

Impact on economic output and revenue growth

Despite making up just 6.0% of all businesses, the Growth Economy accounts for over a quarter of Australia's total economic output. Moreover, over the four years FY18 – 22, the aggregate revenue from the Growth Economy grew faster than the rest of the economy (5.7% CAGR compared to 4.3% CAGR respectively).

With this trajectory, the contribution of the Growth Economy to Australia's total economic output is expected to further increase in the future.

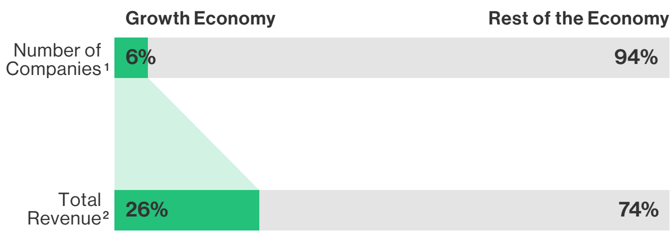


ABGF Portfolio Company: HUBBED
Last mile delivery

FIGURE 1D: GROWTH ECONOMY OUTPUT

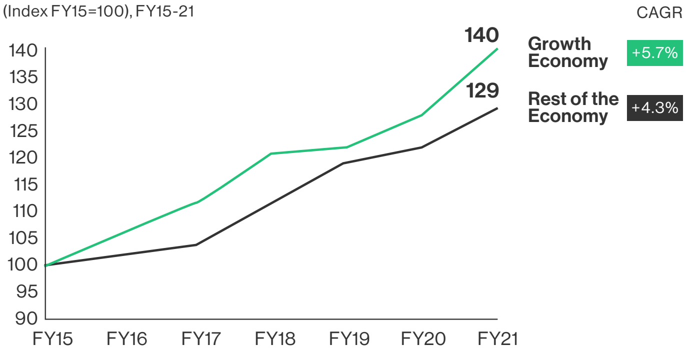
Growth Economy as a proportion of the rest of the economy[3]

FY21



Growth Economy compared to the rest of the economy[3] revenue growth

(Index FY15=100), FY15-21



[1] Number of companies as per calculation in Figure 1A, ABS customised data set, Strategy& analysis.

[2] Revenue calculation based on businesses total revenues reported by the ATO in FY21 as ABS data is not available. Growth Economy refers to businesses revenue between the range of $2m-$100m. Will not tie to ABS data. Strategy& analysis.

[3] Rest of the economy refers to companies with less than $2m and over $100m in revenue reported by the ATO in FY21. Strategy& analysis.

Taking a sector view of this data provides further colour to the overall picture. As illustrated in Figure 1E, Growth Economy businesses outpace the broader economy in their growth in nine sectors and have shown slower growth in only four.

FIGURE 1E: GROWTH ECONOMY BY SECTOR

Sector	Portion of Growth Economy companies in Australia	FY22 Growth Economy revenue	Growth Economy revenue growth '18-22	Growth Economy growth v rest of sector
Accommodation and Food Services	13%	$72bn	+3%	Faster
Construction	12%	$211bn	+6%	Faster
Professional, Scientific Technical Services	11%	$148bn	+8%	In-Line
Retail Trade	11%	$229bn	+6%	In-Line
Health Care and Social Assistance	9%	$61bn	+12%	Faster
Manufacturing	8%	$196bn	+6%	Faster
Wholesale Trade	6%	$308bn	+5%	Slower
Administrative and Support Services	5%	$49bn	+5%	In-Line
Other Services	5%	$41bn	+2%	Slower
Agriculture, Forestry and Fishing	4%	$51bn	+7%	In-Line
Rental, Hiring and Real Estate Services	4%	$47bn	+6%	Faster
Transport, Postal and Warehousing	3%	$67bn	+9%	Faster
Education and Training	3%	$23bn	+1%	Slower
Financial and Insurance Services	2%	N/A	N/A	N/A
Arts and Recreation Services	2%	$17bn	+5%	Faster
Information Media and Telco	1%	$19bn	+11%	Faster
Electricity, Gas, Water and Waste Services	1%	$32bn	+5%	Faster
Public Administration and Safety	0%	$4bn	-3%	Slower
Mining	0%	$74bn	16%	In-Line

Note: Proxy data used to define Growth Economy as 5 – 199 employees due to data structure of ABS data. Source: ABS, ATO, Strategy& analysis.

The key sectors showing higher average growth include:

- **Information media and telecommunications:** Growth Economy businesses in this sector have grown their revenue by 11%, compared to 3% for the rest of the sector;
- **Manufacturing:** Growth Economy businesses have achieved a revenue growth of 6%, surpassing the sector's overall growth of 4%;
- **Health care and social assistance:** Growth Economy businesses in this sector have seen a revenue increase of 12%, while the rest of the sector has grown by 9%;
- **Transport, postal and warehousing:** Growth Economy businesses are achieving growth rates three times faster than the rest of the sector (9% vs. 3%).

Of the sectors where Growth Economy businesses are not outpacing the broader economy, the most notable are retail and wholesale trade. Collectively, these are the largest contributors of Growth Economy revenue, making up almost $540 billion in FY22. However, growth is either in line or slower than the rest of these sectors, demonstrating the economic impacts on smaller players in these consumer-driven sectors.

The inherent flexibility and innovative capacity of Growth Economy businesses enable them to capitalise on niche opportunities and respond swiftly to market needs.

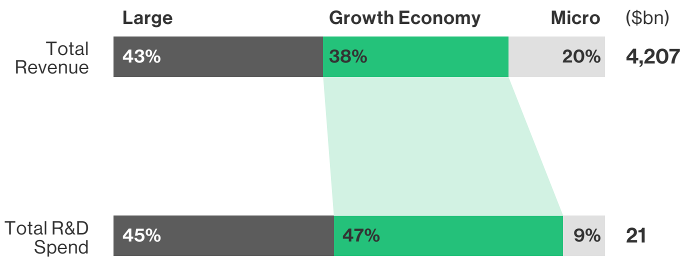
ABGF Portfolio Company: 3ME Technology
Off-highway, heavy-duty vehicle electrification

Impact on research and development

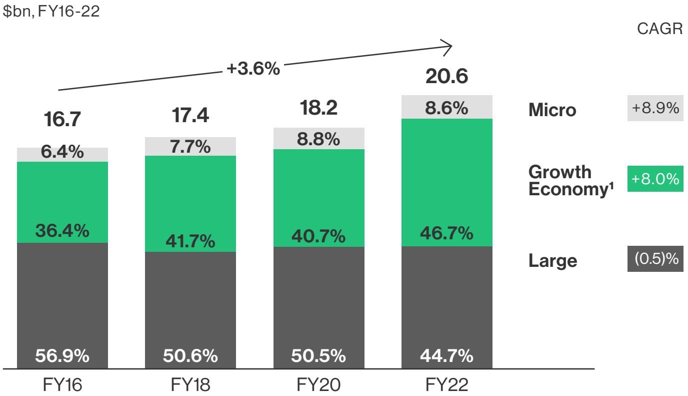
Growth Economy businesses have an outsized contribution to R&D investment in Australia. As Figure 1F shows, they contribute approximately 47% of all R&D spend in Australia. With an 8% CAGR in R&D spend since FY16, this contribution is expected to continue to increase in the future.

FIGURE 1F: GROWTH ECONOMY'S R&D INVESTMENT

Growth Economy[1] R&D spend compared to the rest of the economy
$bn, FY22



Australian R&D spend by business size segment
$bn, FY16-22



[1] Proxy data used to define Growth Economy as 5 – 199 employees due to data structure of ABS data.
Source: ABS Research and Experimental Development, Strategy& analysis.

Given the contribution to economic output and growth, it is no surprise the Growth Economy contributes significantly to employment in Australia.

ABGF Portfolio Company: CLS
Commercial laundry services

Impact on employment

Accounting for 42% of all employment, the Growth Economy provides more jobs to Australians than either large or micro-businesses (see Figure 1G).

Since the COVID pandemic, it has also driven the strongest recovery in employment. In the period FY20 – FY22, employment growth within the Growth Economy was 14% compared to 8% for larger businesses and just 3% for smaller, micro businesses.

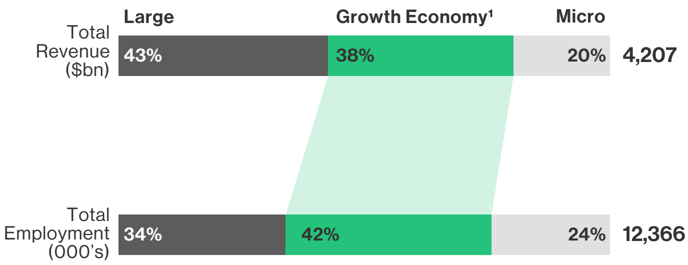
The Growth Economy plays a crucial role in Australia's economic prosperity, so, it is essential to understand the funding landscape they navigate.

The next chapter examines how Growth Economy businesses are funding their operations and the associated challenges and opportunities this presents.

FIGURE 1G: GROWTH ECONOMY EMPLOYMENT GROWTH

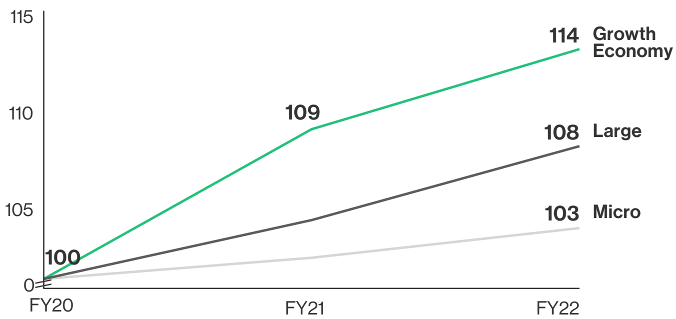
Growth Economy[1] employment compared to the rest of the economy

FY22



Growth Economy[1] employment growth

FY20-22, FY20 (Index=100)



[1] Proxy data used to define Growth Economy as 5 – 199 employees due to data structure of ABS data.
Source: ABS Research and Experimental Development, Strategy& analysis.

ABGF Portfolio Company: 3ME Technology
Off-highway, heavy-duty vehicle electrification

SECTION 2

Growth Economy funding is dominated by debt

SECTION 2

Growth Economy funding is dominated by debt

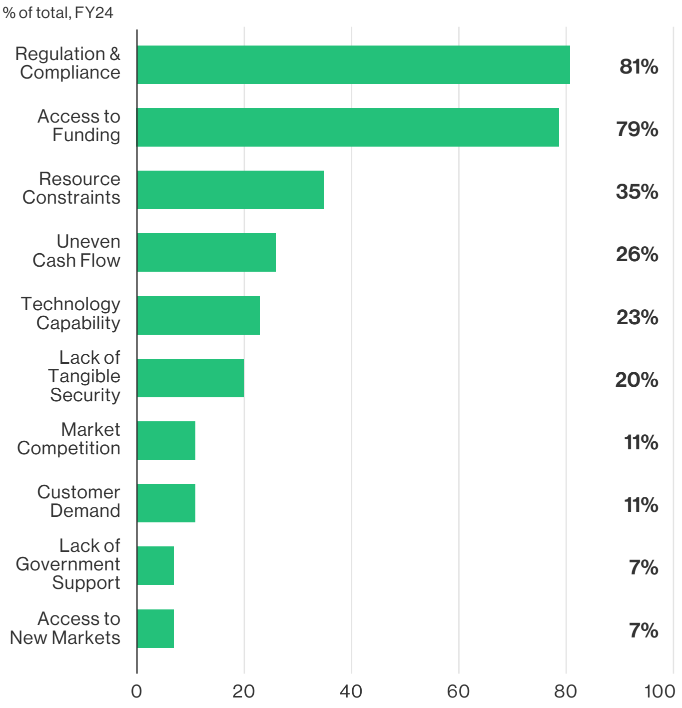
Given the significance of the Growth Economy to Australia's economic prosperity, understanding what these businesses need to support their continual growth is critical. So too is understanding the challenges they face in their endeavours to grow and access funding.

To understand the barriers that have impacted the growth of these businesses, those that have experienced positive or flat growth (or would grow if they had access to equity funding) were asked to share their top barriers to further growth (see Figure 2A).

The leading obstacles to further growth that were consistent across approximately 80% of businesses were regulation and compliance, and access to funding.

Considering the range of funding options available to businesses and the importance of this as a driver of growth, examining Australia's funding landscape will assist in understanding how businesses are financing their growth.

FIGURE 2A: BARRIERS IMPACTING BUSINESSES ABILITY TO GROW

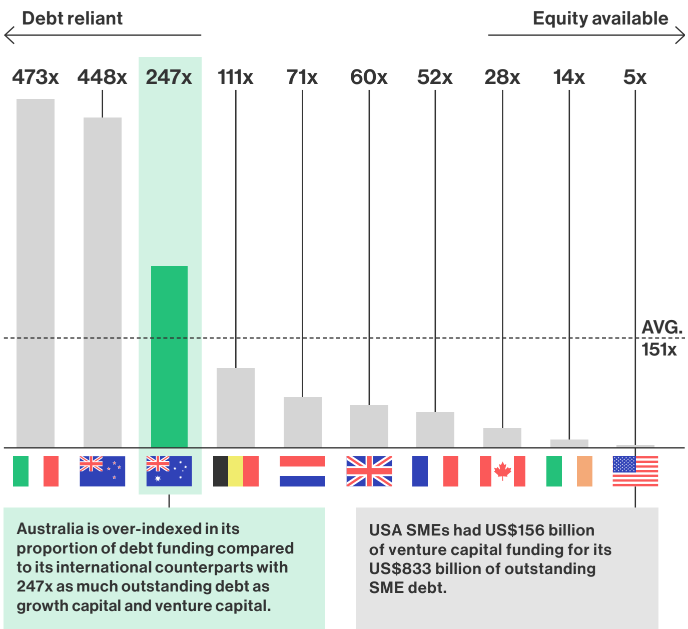


Source: Based on results of East&Partners survey (see Appendix A). Percentage of total. Referenced from survey question 6: "What are the top three barriers to growing your business?"

A comparison of the ratio of outstanding debt to growth capital and venture capital for SMEs across Organisation for Economic Co-operation and Development (OECD) countries reveals a striking contrast between how Australian businesses and their counterparts in other countries fund their operations. The analysis in Figure 2B reveals that Australian SMEs are much more reliant on debt funding than growth capital and venture capital (247x) relative to their peers in other OECD countries such as US, UK, Ireland, Canada and France. This would seem to indicate much more mature and deep debt funding markets in Australia against a backdrop of very limited availability of growth and venture capital, as we will explore in subsequent pages.

FIGURE 2B: INTERNATIONAL EQUITY INVESTMENT

SME ratio of outstanding debt to growth capital and venture capital[1]
2020



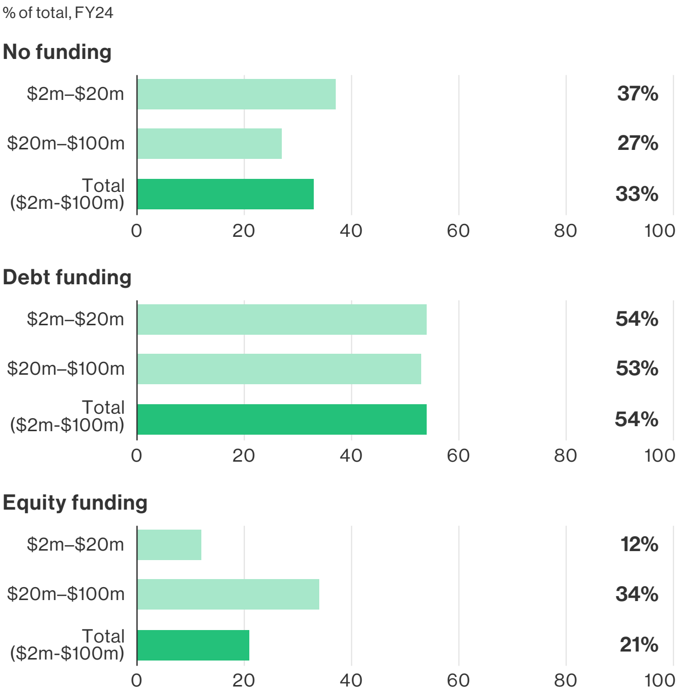
[1]Based on OECD definition of growth capital and venture capital.
OECD definition of SMEs: "SMEs are defined as non-subsidiary, independent firms which employ fewer than a given number of employees. This number varies across national statistical systems. The most frequent upper limit is 250 employees"
Source: OECD, World Bank, Strategy& analysis.

Whilst debt markets in Australia are relatively mature and access to debt funding for businesses is broadly available, the comparison to OECD countries suggests that Australian businesses have comparatively less access to equity funding than most of their OECD counterparts.

Growth Economy businesses with positive or flat growth (or those that would grow if they had access to external equity funding), were asked how they are funding their business.

Figure 2C sets out the funding mix of Growth Economy businesses – the proportion of businesses with equity and/or debt or with no external funding.

FIGURE 2C: GROWTH ECONOMY BUSINESSES FUNDING MIX



Source: East&Partners question 5 "What approximate external funding mix are you currently using to finance your business?". % of total. Note: total does not equal 100% due to multiple responses across equity and debt funding answers.

In summary:

- a third have no external funding;
- over half have debt funding;
- a fifth have externally sourced equity funding.

While this data supports the OECD leverage analysis and indicates a much higher prevalence of debt in the system over equity, further analysis is required to determine the extent to which this low level of equity funding is due to demand or supply constraints. This analysis will be addressed in sections 3 and 4, along with analysis to quantify this gap between the demand and supply of equity capital in the Growth Economy.

What the data does reveal however, is the noticeable difference between the size of a business and its mix of debt and equity.

Whilst the percentage of Growth Economy businesses with debt funding is consistent regardless of their size, there is a marked difference between a businesses revenue and its reliance on external equity funding. As per Figure 2C, the percentage of Growth Economy businesses with external equity:

- **34%** with revenue between $20 million and $100 million per annum; versus
- **12%** with revenue between $2 million and $20 million per annum.

So, as businesses grow, equity becomes an increasingly significant component of their funding mix.

The Productivity Commission and many others have researched SME access to debt finance in Australia and the evolving lending market. However, there has been limited research into the accessibility of external equity for SMEs, the sources from which SMEs obtain external equity, and the quality of the investment partners they can access. Therefore, it is necessary to determine if Australian SMEs are underfunded in terms of sourcing external equity. This requires an investigation into the level of demand for external equity and whether there is an adequate and appropriate supply to meet that demand. This is the core of the research outlined in this report and is covered in the following two sections.

ABGF Portfolio Company: HMC Group
Aviation and tourism

SECTION 3

There is a $38 billion external equity funding gap

SECTION 3A

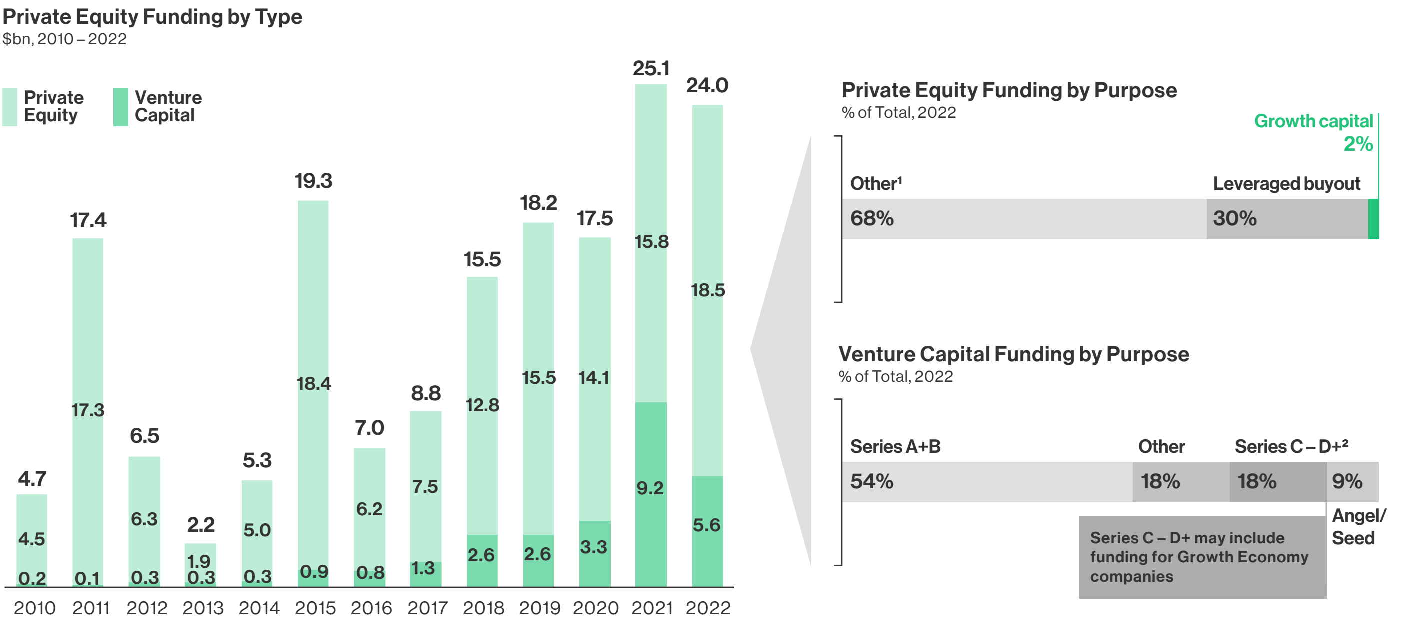
Supply of externally sourced equity

The private equity market in Australia has grown significantly over the last decade, particularly as the economy has recovered from pandemic-related disruptions.

Private equity funds have deployed substantial amounts of capital, reaching a record $25 billion in 2021.

As a result, funds under management (FUM) in Australian-focused private equity funds have nearly tripled in size since 2010, reaching $65.5 billion according to the Australian Investment Council. However, a more nuanced picture emerges when the type and purpose of the different forms of private equity funding is considered.

FIGURE 3A: EQUITY FUNDING BY TYPE AND PURPOSE



[1]Other includes: add-on, private investment in public equity, public-to-private, and recapitalisation.

[2]Other includes: add-on, grant, private investment in public equity and venture debt.
Source: Preqin, Strategy& analysis.

Per the graph on the right-hand side of Figure 3A, the majority of capital is concentrated on recapitalisations, shifting equity from public to private markets, and large buyouts. The record growth in the Australian private equity market has primarily been driven by a small number of substantial leveraged buyouts, according to the RBA. Additionally, there has been increasing investment in early-stage, start-up businesses through venture capital funding, particularly over the past five years.

Despite this growth, only a minimal amount of private equity investment is being deployed as growth capital – that is, investment to expand operations, launch new products, or enter new markets. As Figure 3A shows, in 2022, growth capital investments accounted for a mere 2% of total private equity funding in Australian businesses.

To better understand the dynamics driving this low level of growth capital deployment, it is necessary to examine the demand side of this equation. The following section will explore the experiences of Growth Economy businesses in seeking growth capital.

SECTION 3B

Demand for externally sourced equity

There is strong demand for external equity capital amongst Growth Economy businesses. Despite the limited allocation of growth capital in the Australian economy, 35% of Growth Economy businesses sought equity capital in the past three years (see Figure 3B).

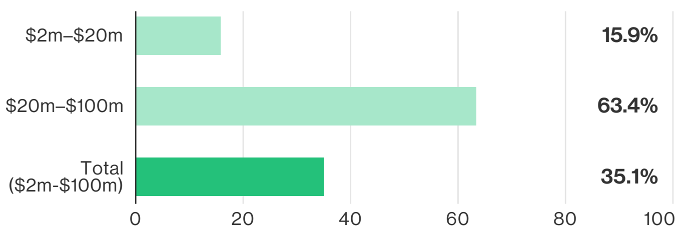
Furthermore, larger Growth Economy businesses (with $20 million to $100 million revenue) are four times more likely to have sought equity capital than smaller businesses (with $2 million to $20 million revenue) with 63% of these larger businesses seeking capital in the past three years (versus 16% for smaller businesses). These findings suggest there is significant demand for equity capital in the Growth Economy, which will be examined later in this section.

However, over half (53% as per Figure 3C) of businesses that sought equity in the past three years were unsuccessful. This situation is even more challenging for smaller Growth Economy businesses with $2 million to $20 million revenue, where over two-thirds were unsuccessful in securing capital. These businesses therefore face trade-offs in terms of their funding options – bootstrapping their way to growth or turning to alternative (more expensive) debt funding sources. In many cases, these businesses end up trading off growth in the absence of additional equity capital.

There is also the other side of this equation – a third of Growth Economy businesses with $2 million to $20 million revenue and just over half of businesses with $20 million to $100 million revenue were in fact able to access some level of equity when sought over the last three years. So, from whom did they access this equity, and did it meet their needs?

FIGURE 3B: BUSINESSES THAT HAVE SOUGHT EXTERNAL EQUITY IN PAST THREE YEARS

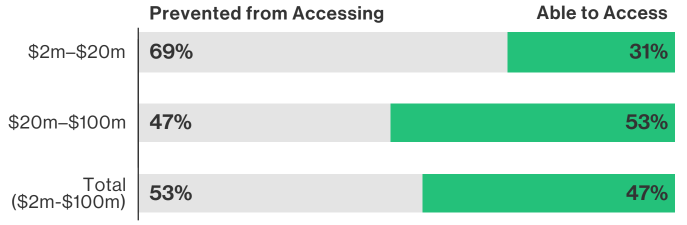
% of responses, 2024



Source: Based on percentage of businesses who had sought equity in the past three years and answered East&Partners survey reference question 7: "What is the average value of equity funding you have sought in the last three years?", East&Partners.

FIGURE 3C: BUSINESSES THAT ACCESSED EQUITY WHEN SOUGHT

% of responses, 2024



Source: question 11: "Have you been prevented from accessing equity funding in the last three years?", East&Partners.

Panellists from the the Reserve Bank of Australia's Small Business Finance Advisory Panel "noted a preference for equity over debt, including because it provided greater flexibility during the early stages of a business and because of the strategic guidance offered by some private equity investors."

Recent Developments in Small Business Finance and Economic Conditions (2023), Reserve Bank of Australia

For those businesses that have successfully raised capital, the source of the equity is skewed towards non-institutional, personal connections.

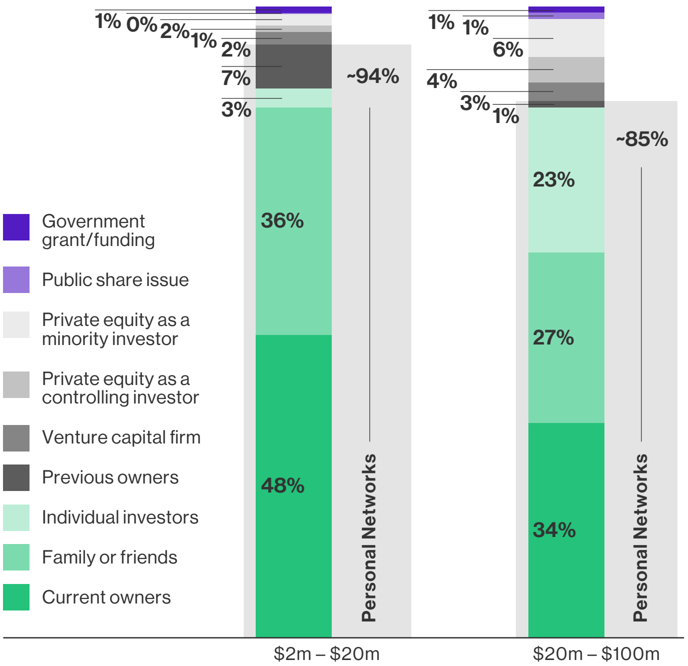
The breakdown of external equity sources is shown in Figure 3D.

This shows that 90% of equity sourced is from personal networks – current or previous owners, family/friends and individuals.

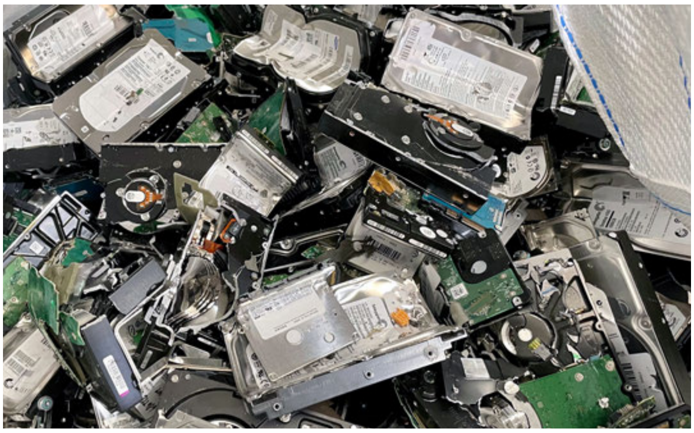
Unfortunately, personal investors often lack the necessary expertise and connections to adequately help businesses scale, which is a core competency of institutional investors.

FIGURE 3D: SOURCES OF EQUITY FUNDING

% of total, FY24



Sources: Based on results of East&Partners survey. Referenced from survey questions 11: "Have you been prevented from accessing equity/debt funding in the last three years?" (Equity answers only) and 14: "What has been your primary source of additional equity in the past?".



ABGF Portfolio Company: Total Green Recycling
E-waste recycling

"From the corner store to the car dealership, ensuring that these businesses have access to flexible financing – be it debt or equity – is essential for innovation, employment, and the economic fabric of our nation. As the Australian Small Business and Family Enterprise Ombudsman, I am passionate about championing initiatives that provide small and family businesses with the growth capital they need to thrive."

Bruce Billson – Australian Small Business and Family Enterprise Ombudsman

So, while there has been significant growth in the supply of private equity capital in the Australian market and evidence of substantial demand for external equity amongst Growth Economy businesses, very little is being deployed as growth capital. Even when these businesses are successful at raising capital, only a small percentage is sourced from experienced institutional investors.

SECTION 3C

Quantifying the external equity funding gap

The evidence highlights a fundamental market failure in the demand and supply of externally sourced equity capital, where Growth Economy businesses do not have sufficient access to the type or amount of external equity they need to grow.

This is reflected in Figure 3E below, highlighting the Growth Economy external funding gap. The next challenge is to quantify this funding gap.

FIGURE 3E: EXTERNAL EQUITY FUNDING LANDSCAPE OVERVIEW

Equity

Public Equity

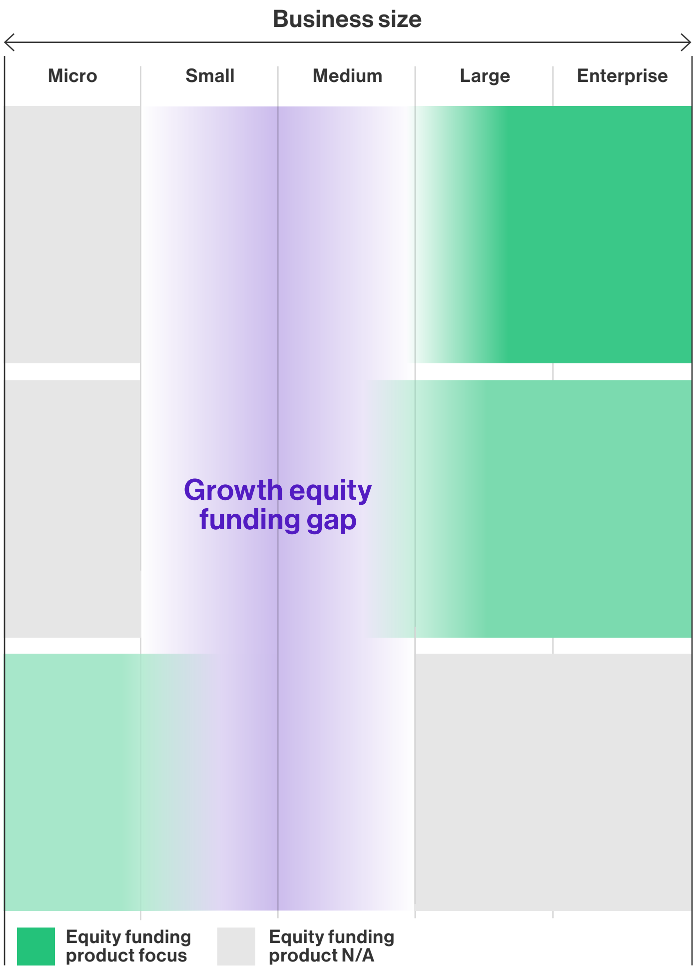
Public equity refers to ownership shares in publicly traded companies, available for purchase on stock exchanges. Public equity represents a form of ownership that provides investors with a stake in a company's performance and potential dividends.

Private Equity

Private equity involves investing in non-publicly traded companies, with funds from institutional and high-net-worth investors. These firms actively manage and aim to improve the performance of their portfolio companies, ultimately seeking returns for their investors.

Venture Capital

Venture capital is a form of private equity financing that investors provide to start-up and small businesses with high growth potential. In return, venture capitalists typically receive equity ownership in the companies they invest in.



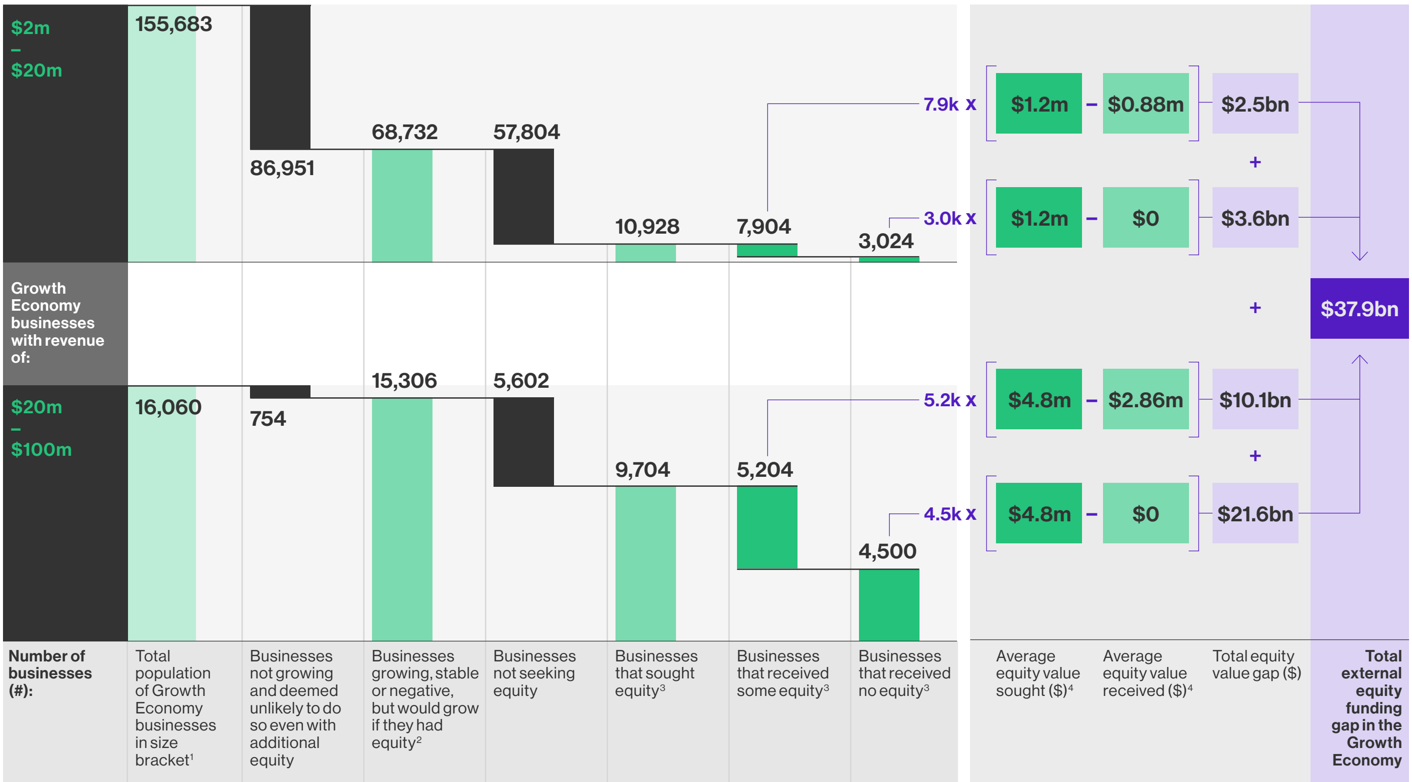
The following analysis provides an estimate of the size of the equity funding gap by calculating the proportion of Growth Economy businesses that sought equity funding and the average amounts they sought and received, the disparity between the two can be estimated. Applying this difference to the overall population of growth-oriented businesses then quantifies the external equity funding gap. This calculation is shown in Figure 3F.

This calculation yields an estimated external funding gap of $38 billion for Growth Economy businesses.

FIGURE 3F: SIZING THE EXTERNAL EQUITY FUNDING GAP

Current average equity funding gap*

FY24*



*Based on results of East&Partners survey, Strategy& analysis.

[1] Number of businesses is FY22 total extrapolated by FY21 – FY22 growth rate to reflect number of Growth Economy businesses in FY23.

[2] Growing SMEs are those that responded to the East&Partners survey that were either growing, flat or negative but would grow if they had equity. These category of businesses are used as a proxy tor the equity funding gap because they exclude those that are growing negatively and stated they would not grow if they had equity (a category of businesses that are extremely unlikely to raise equity even if the funding was available in the market).

[3] Percentage of businesses that sought, received or did not receive equity in each category based on East&Partners survey.

[4] Referenced from survey question 5: "What approximate external funding mix are you currently using to finance your business? And question 7: "What is the average value of equity and debt funding you have sought in the last three years".

The external equity funding gap of $37.9bn is determined by considering all businesses within the Growth Economy that sought equity in the past three years, and which could potentially achieve growth with additional equity.

Although the estimated $38 billion represents a significant gap, it reflects a point-in-time assessment that encompasses an economy-wide perspective across all sectors and regions of the country, thus providing the broadest definition of the external equity funding gap in the market.

ABGF Portfolio Company: HUBBED
Ghazaleh Lyari (ABGF Co-Head of Investments) and David McLean (HUBBED Founder and CEO)

However, there are a couple of limitations to this analysis worth mentioning. Firstly, not all businesses that seek external equity will meet an investor's criteria – their value proposition may not be distinctive enough, their profitability may not be strong enough, their growth profile may not be attractive enough, or the sector they operate in may be outside the investment mandate. Irrespective of these details, there is a clear and substantial external equity funding gap in the Growth Economy.

There will be a number of dynamics at play on both the demand and supply side that are contributing to the persistence of the identified funding gap. It is therefore important to explore the perspective of Growth Economy businesses that have sought or are seeking growth capital; and just as important, to understand the reasons why there may be limited supply of growth capital from investors. These perspectives will be explored in the next chapter.

"Australia's private capital investment market has grown steadily and significantly over the past decade making a substantial contribution to Australia's economy. Despite this progress, our current levels of private capital are a fraction of the total funding required to meet Australia's most pressing priorities. Private capital investors like the Australian Business Growth Fund are taking a targeted approach to address the unmet financing needs of certain segments of the economy, in this case Australia's SMEs."

Navleen Prasad – CEO, Australian Investment Council

ABGF Portfolio Company: Kikada Dental Group
Dental clinic network

SECTION 4

The different needs of founders and investors are causing the gap

SECTION 4

The different needs of founders and investors are causing the gap

Closing the Growth Economy equity funding gap may not be as simple as increasing the supply of capital.

As outlined in Section 1...

...Growth Economy businesses punch above their weight across key economic indicators.

Meanwhile, as outlined in Section 2...

...the volume of equity capital flowing into the Australian economy has increased over the past 10 years.

Yet, as outlined in Section 3...

....very little of that equity capital has been in the form of growth capital for Growth Economy businesses, pointing to a significant gap in the market between demand and supply.

ABGF Portfolio Company: INSKIN Cosmedics
'Cosmedical' skincare

In addressing and narrowing this gap, there is unlikely to be a single solution, so it will require a range of approaches. For example, part of the gap may be met by an increase in supply of funding from commercial equity investors and/or higher risk debt providers, some increase in risk appetite from commercial banks, or additional contributions from family and friends. Alternatively, businesses may simply decide not to pursue their growth ambitions, therefore reducing the demand for external equity.

But why is there such a disconnect between investors and Growth Economy businesses?

SECTION 4A

The preferences of investors

On the supply side, feedback from private equity investors suggests there are several contributing factors that explain why investors may be reluctant to invest in Growth Economy businesses.

Private equity investors seek to maximise returns, but the time and management resources required to oversee investments – such as board appointments and governance – are virtually the same, whether the investment is large or small.

As a result, larger investments provide far better returns for the same effort. For example, managing a $1 billion portfolio made up of 20 investments yields ten times the revenue of a $100 million portfolio with the same number of investments also with 20 investments, despite requiring similar resources. As higher FUM also generates higher fees, this makes fewer, larger investments become a more logical choice from an ROI perspective.

Secondly, less mature, smaller businesses are typically a higher risk investment than larger, more established businesses.

They depend heavily on key individuals or products, making them vulnerable to disruptions, which increases their risk profile. Investors, therefore, demand significantly higher returns from these businesses to justify the greater risk.

Additionally, smaller businesses, all other things being equal, tend to command less market power than larger firms. Their competitive positions are typically weaker and more susceptible to changes in the economy, overall demand, or shifts in competitive forces.

Irrespective of the size of the investment, private equity investors prefer to have control rights over the business they invest in. This is so they can enforce change, drive outcomes and manage the timing of exits. This issue of control is a key issue for founders, which will be addressed in the following section.

Conversely, venture capital investors, while similarly focused on high returns, look for smaller investments in businesses that can scale rapidly at minimal cost. The ideal candidates for venture capital are businesses like software companies, where products can be distributed and replicated at near-zero marginal cost. These characteristics make them highly attractive and capable of delivering the outsized returns that venture capitalists seek.

Given venture capitalists require a high return on a relatively small investment, they need to enter a company's journey early. More mature businesses also don't offer the same potential for very high growth rates that will deliver the returns venture capitalists require from their investment.

Private equity and venture capital investors typically shy away from growth capital for businesses in the Growth Economy. Private equity focuses on control and efficiency through larger investments, while venture capital aims for rapid scalability and high returns from early-stage, high-growth businesses. While there are some investment options for founders, they remain limited.

While understanding the preferences of private capital investors is important from the supply side, it is equally important to understand the preferences of founders seeking capital from the demand side, which we explore in the next chapter.

"We chose ABGF because their growth capital will fast-track our expansion and boost our capacity and efficiency. Importantly, ABGF respects our wish to maintain control, honouring the values my father instilled in our family business. As an experienced and active investor, ABGF also offered us more than just funding—they bring expertise, resources, and connections that are invaluable as we continue to innovate and break new ground. In an industry where reliability is crucial, ABGF will help us continue to set new benchmarks for excellence in regional Queensland's linen services."

Adam Roberts – Managing Director, Consolidated Linen Service

SECTION 4B

The expectations of Growth Economy businesses

To gain insight into the experience of Growth Economy businesses when sourcing external equity, they were asked about the challenges they encounter with existing equity funding models.

The most common response (from 81% of respondents), was that an investor provided no value beyond the equity they provided (see Figure 4).

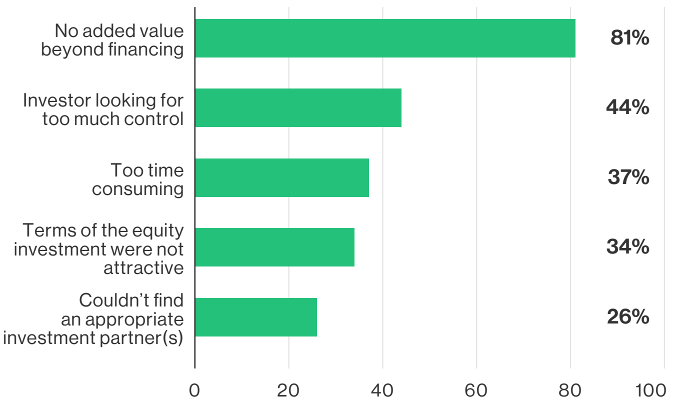
The alternative way to express this is: growing businesses are looking for more than just capital – they are looking for an active investor that has the capabilities and connections to help them grow.

The second most common challenge in accessing equity was investors wanting to take too much control of the business.

Founders of growth businesses understand there is a future financial benefit for them to retain a significant stake in their business, and they want to remain in control and lead the business through the next phase of growth.

FIGURE 4: CHALLENGES WITH EXISTING FUNDING MODELS

% of responses, FY24



Source: Based on results of East&Partners survey, referenced from question 5: "What approximate external funding mix are you currently using to finance your business?" (Note: only respondents using external funding considered), and 12: "What are three (up to) top barriers you have encountered sourcing equity/debt funding?".

Investors may find the perspectives of Growth Economy businesses to be contradictory – these businesses want capital and active support from investors – but they don't want to give up control in the process.

As the perspectives of investors and founders are laid out, the $38 billion equity gap in the Growth Economy can substantially be explained by the economics of investing in this segment and a disconnect between the expectations of founders and the preferences of investors.

As a result, simply injecting more of the same capital into the Growth Economy may not materially reduce the externally sourced equity funding gap. Instead, a different type of equity capital model is needed.

Before addressing this opportunity, it is important to first understand the potential impact that access to the right sort of equity (at scale) could have on businesses in the Growth Economy.

> **"One of my top takeaways from nearly 30 years of SME research is that not all business owners want to grow their companies. Some want to grow big, but most don't because they want to keep control. Many SME owners feel that if their business gets bigger, they might not be able to call the shots as much. So, even though growing businesses are good for the economy, the fear of losing control is a big reason many don't go for it. It's not just about money; it's also about how comfortable they feel being the boss as they grow. To simply broaden access to equity funding isn't enough, it must be done on terms which keeps owners in control."**
>
> Ross Cameron – Founder, Cameron Research

ABGF Portfolio Company: Solbari
Sun-protective apparel and accessories

SECTION 5

Narrowing the external equity funding gap will drive growth

SECTION 5

Narrowing the external equity funding gap will drive growth

Section 3 analysed the demand and supply of equity capital into the Growth Economy and quantified the equity funding gap apparent from that analysis. This section examines the consequences of the funding gap for Growth Economy businesses and the potential upside of bridging this gap across the entire Growth Economy.

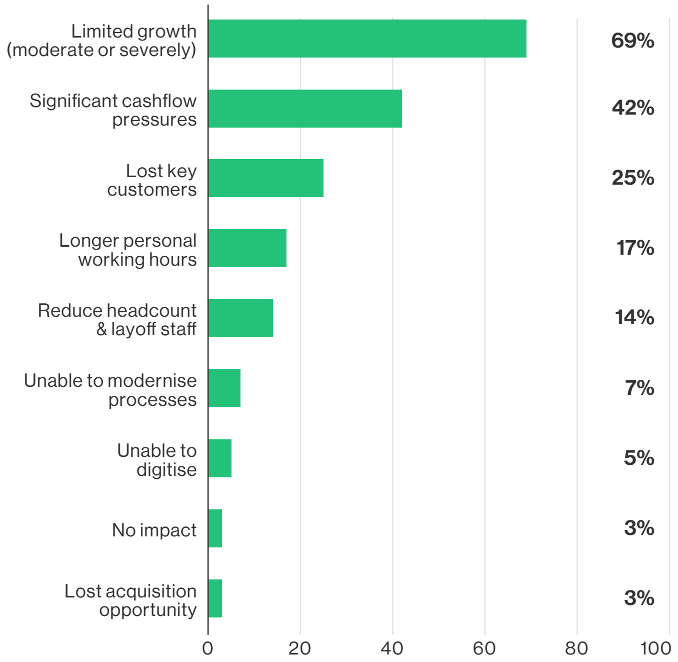
To better understand the impact of the funding gap, businesses were asked about the operational challenges they face due to inadequate access to appropriate external equity funding. As can be seen from the results below, the most significant impact was on revenue growth.

Almost 70% of respondents said they experience a negative impact on their business growth because of the lack of adequate external equity funding (see Figure 5A).

When the growth of a business is constrained, it can have flow-on effects to business decisions, potentially hindering its ability to attract and retain talent, invest in R&D, or maintain profitability. Businesses may also need to delay hiring new staff or defer expanding their operations.

FIGURE 5A: IMPACTS OF LACK OF ADEQUATE EQUITY FUNDING

% of responses, FY24



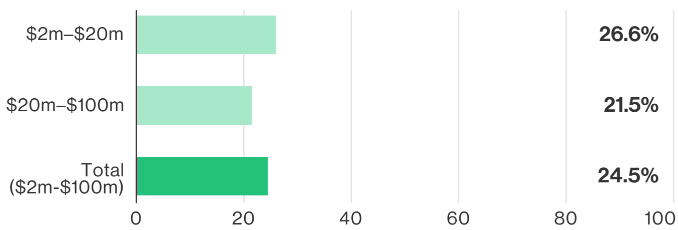
Source: Based on results of East&Partners survey question 16: "What negative impacts has your business experienced from not accessing adequate equity and/or debt funding?". Note: respondents were able to answer more than one response. Strategy& analysis.

On the flip-side, businesses were asked about the potential impact on the growth of their business if they were able to access the equity funding they needed.

In response, businesses estimated that access to the external equity they needed would result in a 24.5% increase in revenue growth, with smaller businesses projecting even higher rates of 26.6% (see Figure 5B).

FIGURE 5B: POTENTIAL REVENUE GROWTH FROM ADEQUATE EQUITY FUNDING

% of responses, FY24



Source: Based on results of East&Partners survey. Referenced from survey question 17: "How much additional revenue growth would you achieve if you had access to adequate equity funding?".

Not surprisingly, these Growth Economy businesses are held back when they can't source the external equity they need to grow. Conversely there is real upside if they can access that external equity funding, which would have a flow-on effect across the Australian economy.

For a segment of the Australian economy that is so important in terms of economic output, R&D and job creation, solving the external equity funding gap within the Growth Economy would have a significant impact on the overall growth and prosperity of the Australian economy.

ABGF Portfolio Company: Derwent Industries
Industrial product manufacturer

SECTION 6

The Growth Economy can advance Australia's sovereign capabilities

SECTION 6

The Growth Economy can advance Australia's sovereign capabilities

As Australia seeks to strengthen its sovereign capabilities and rebuild its industrial base, there is increasing recognition that new funding models are needed to bolster the growth and innovation potential of the SME sector which, as demonstrated in this report, suffers from limited access to external equity funding.

In his essay on a new values-based economy, Australia's Federal Treasurer, Dr Jim Chalmers wrote about how to build a more inclusive and resilient economy. Specifically:

> **"By reimagining and redesigning markets – seeking value and impact, strengthening safeguards and guardrails in areas of unchecked risk. And with co-ordination and co-investment: recognising that government, business, philanthropic and investor interests and objectives are increasingly aligned and intertwined."**
>
> Dr Jim Chalmers – Federal Treasurer
> *My vision for a new values-based capitalism.*
> As reported by the Australian Financial Review (AFR), January 27, 2023.

On 18 September 2023, the National Reconstruction Fund (NRF) was established with the purpose of guiding investment to fill the funding gap for critical industries and in areas of the economy that lack sufficient access to capital (debt, equity and guarantees).

The NRF's objective is to build sovereign manufacturing capabilities across seven key segments:

1— Value-add in agriculture, forestry and fisheries;

2— Value-add in resources;

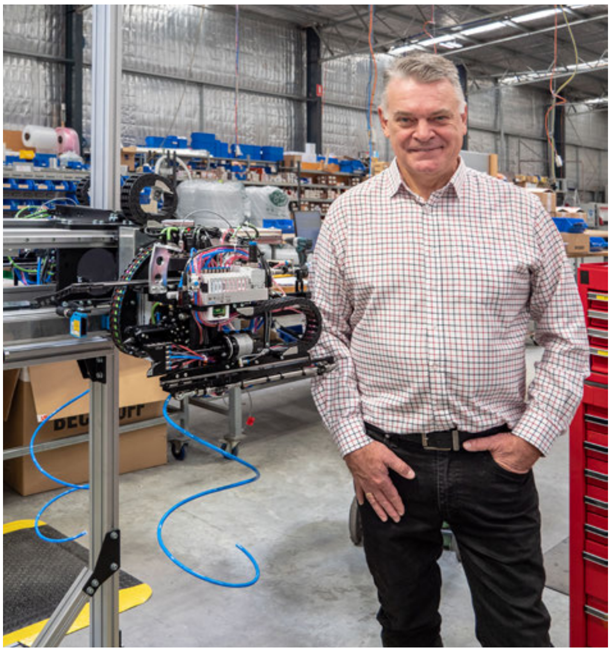
3— Medical science;

4— Transport;

5— Renewable and low emissions technologies and recycling;

6— Defence capability;

7— Enabling capabilities (i.e. technology).



ABGF Portfolio Company: Modra Technology
Tim Modra (Modra Founder and CEO)

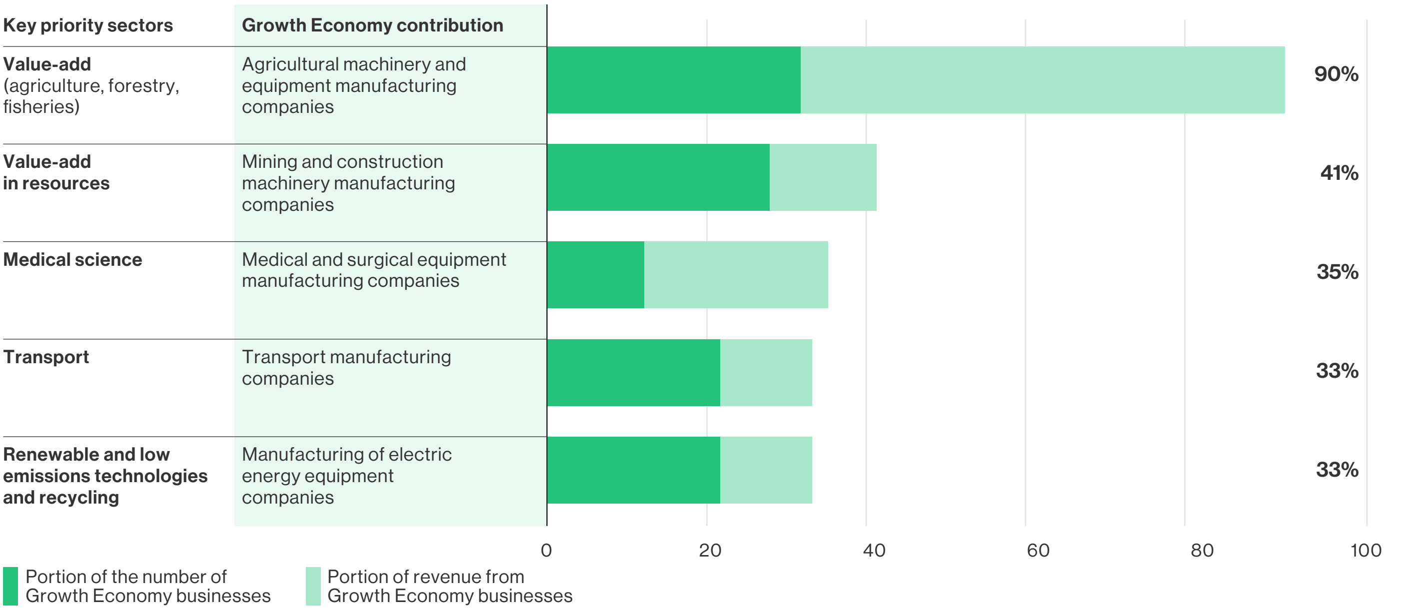
Given the out-sized contribution of SMEs to the overall Australian economy, they are clearly a vital component of these priority areas in delivering the economic objectives specified by the government. Indeed, the former NRF CEO, Ivan Power, stated the importance of SMEs in driving innovation and developing our sovereign capabilities when he was interviewed by the Australian Financial Review:

> **"If you delve into where innovation is happening in the economy and where industrial capability is often based and grown, it's very often these smaller and less mature firms."**
>
> Ivan Power – Former CEO, National Reconstruction Fund
> Former NRF CEO Ivan Power's *plan to tap bigger pools of capital for SMEs* (afr.com)
> As reported by AFR, April 9 2024.

While the proportion by number of Growth Economy businesses operating within the NRF's priority segments is typically low, ranging from 16% to 33%, their contribution to revenue, as per the earlier analysis, is significantly higher than that of the rest of the economy.

FIGURE 6: SME CONTRIBUTION TO PRIORITY SEGMENTS

% of responses, FY24



Note: Revenue estimates based on average revenue by business size in manufacturing sector times of companies by size in each manufacturing sub-division. Transport manufacturing revenue by business size not available so total transport sector revenue included for reference, Strategy& analysis.

Source: National Reconstruction Fund (NRF) Consultation Paper 2022-23, Defence Industry Australian Government, Strategy& analysis.

As Figure 6 illustrates, in four of the segments, SMEs contribute between 33% to 41% of revenue, with those in the agricultural machinery and equipment manufacturing sector accounting for 90% of the revenue.

Figure 6 does not include two of the NRF's priority segments, defence and enabling capabilities, due to data availability. However, there are over 3,000 SMEs in Australia that are developing innovative technologies, such as software development, precision manufacturing, and specialist engineering, to enhance the capabilities of the Australian defence sector.

SMEs are critical in delivering government priorities that will diversify and transform Australia's industry and economy. While government initiatives are well set up to support early-stage SMEs through venture capital and grant programs, more needs to be done to unlock the flow of equity capital into the Growth Economy. To address this, government initiatives should leverage established investment platforms focused on SMEs. One such example is the unique public-private-partnership (PPP) model of the Australian Business Growth Fund.

SECTION 7

The role of patient, minority capital

SECTION 7

The role of patient, minority capital

Existing funding models are not solving the equity funding gap that exists within the Growth Economy. A new model for equity investment is therefore needed, including different investors and legal structures.

Limitations of traditional fund models

Private equity and venture capital are typically structured on a partnership model comprising General Partners (GPs) and Limited Partners (LPs). GPs are the investment professionals, or fund managers, who manage the fund and make investment decisions; LPs are institutional or high net worth individuals who provide the capital for GPs to invest on their behalf. As outlined in Section 4, GPs are paid a management fee based on FUM and a share of sale proceeds once these proceeds exceed a minimum return threshold.

As LPs seek to maximise returns, GPs are incentivised to make larger investments (given relatively fixed management costs) and exit in the shortest possible timeframe (to amplify returns over shorter timeframes). To avoid concentration risk, both LPs and GPs typically seek a maximum exposure of 15% of a fund in a single investment, therefore making six to ten investments per fund. This structure is not conducive to smaller investments, as they don't provide the same economic efficiency, nor does it incentivise long-term, patient investment, as the focus is on rapid returns. The model also heavily relies on acquiring a majority share of a business to control outcomes, including exit timeframes. Furthermore, it typically does not allow for an evergreen fund, where the initial capital is reinvested into new businesses after the fund exits an investment.

Therefore, a new investment fund model is required to provide Growth Economy businesses with equity that leaves the founder in control, with a longer-term investment horizon, and active support beyond the provision of the capital.

A new type of investment fund model

In recognition of the gap in the market for long-term patient minority capital for SMEs, the Federal Government and six leading banks came together to create a new investment fund. They shared a common interest and had the necessary capital to establish a new investment vehicle that could efficiently and effectively deploy their capital, without the constraints of traditional fund models.

In October 2020, the Federal Government announced the formal establishment of the Australian Business Growth Fund (ABGF), Australia's only purpose-built fund dedicated to providing patient growth capital to the SME sector. ABGF was established as a proprietary limited company, enabling the provision of permanent (evergreen) investment capital. Under this model, investment decisions are made independently of shareholders and non-executive directors, with ABGF management accountable for delivering commercial returns to shareholders within a defined investment mandate. This enables investment decisions to be free from political and board influence and driven purely by commercial considerations in alignment with the agreed investment mandate. Additionally, the model enables a market-oriented approach to recruitment and retention, offering competitive compensation to attract experienced professionals to drive the Fund's success.

From the Government's perspective, ABGF supports broader national economic priorities by fostering SME growth, creating jobs, and aiding economic recovery, particularly in the aftermath of the COVID-19 pandemic. This alignment with national policies and initiatives ensures that the Fund's activities contribute to sustained economic growth and development.

Bank shareholders were motivated to establish ABGF to optimise their customers' capital structures, support customer growth and retention, and provide an alternative to traditional debt financing. Ultimately, introducing ABGF as an equity partner fosters long-term relationships with business customers and allows banks to deepen those relationships, creating opportunities for mutual growth.

This PPP model provides ABGF with a robust and effective model to support economic growth, creating a sustainable environment for Growth Economy businesses to thrive.

The Australian Business Growth Fund (ABGF) investment mandate

ABGF was initially established with $540 million of growth capital to invest. The purpose of the Fund is to ensure "small and medium-sized businesses have access to the equity finance they need".

More specifically, the Fund was established to:

1— Increase the availability of patient equity capital to Australian SMEs;

2— Increase the level of investment in SMEs across Australia;

3— Facilitate interstate and overseas trade and commerce;

4— Support job creation and economic growth.

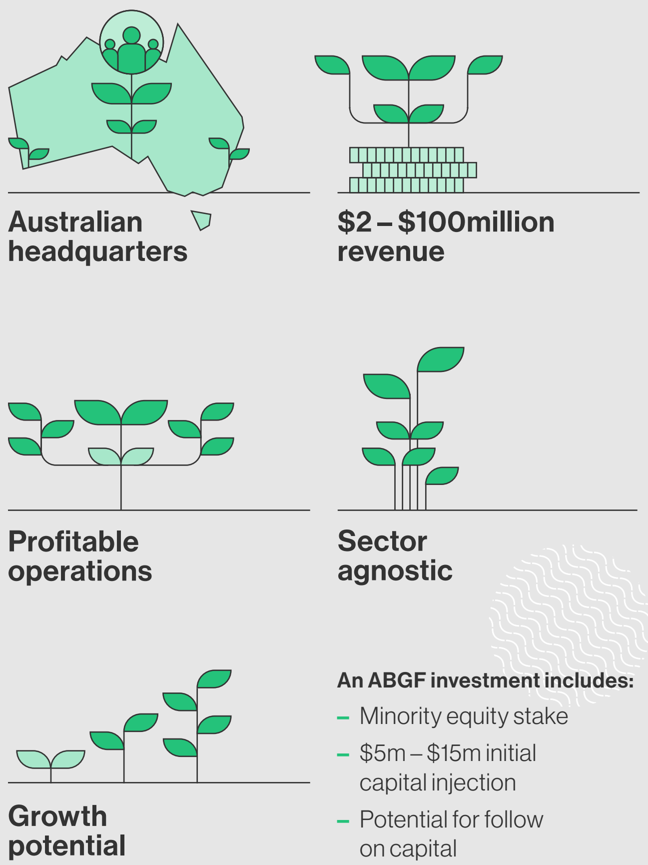
Source: Treasury's press release

ABGF's approach to investment addresses the challenges SMEs have historically faced when accessing equity capital. With initial investments ranging from $5 million to $15 million, ABGF investments are appropriately sized for Growth Economy businesses, which typically require larger investments than those offered by venture capital funds or individual investors, but smaller than those typically considered by private equity and larger buyout funds.

Additionally, ABGF's mission goes beyond financial investment by bringing together the capital, capabilities and connections businesses need to grow. This is achieved while only taking a minority stake in the business— leaving the founder in control. Importantly, the timeframe of investment is 'patient', lasting up to 10 years, with the founder (or the majority shareholder), determining when the Fund can exit or sell down its shares.

ABGF's investment mandate has a targeted approach and only invests in businesses that operate within the Growth Economy. That is, Australian businesses with a proven business model and a track record of success. These businesses generate revenues between $2 million and $100 million, have achieved at least three years of revenue growth and profitability, can demonstrate a unique value proposition, and are open to partnering with an active investor. This mandate is outlined in Figure 7.

FIGURE 7:
AUSTRALIAN BUSINESS GROWTH FUND
INVESTMENT REQUIREMENTS



Beyond the economic impact of the $540 million of investment capital, ABGF's ultimate success will be to demonstrate this model works, thereby demonstrating to other investors that there is a commercially viable way to provide equity to Growth Economy businesses. Specifically, to show there is a commercially viable way to provide equity to Growth Economy businesses. Only through the collective efforts of the investment community can the $38 billion gap start to close. Ultimately, investing in Australian entrepreneurs, disruptors and growth-oriented businesses will unlock economic benefits for all Australians.

AUSTRALIAN
BUSINESS
GROWTH
FUND

> "As Australia's largest business bank, NAB is firmly committed to supporting our small and medium sized businesses develop and expand. The Australian Business Growth Fund (ABGF) is an excellent example of how growth capital can be deployed at scale to SMEs to assist with their long-term expansion and success without sacrificing hands-on, value-add support. As growth capital becomes more accessible in greater volumes, this will mean more jobs, more economic growth and more opportunities for Australian businesses."

Andrew Irvine – CEO, NAB

SECTION 8

Economic modelling demonstrates the impact of additional growth capital

SECTION 8

Economic modelling demonstrates the impact of additional growth capital

With a $38 billion equity funding gap across the Growth Economy, deploying ABGF's $540 million of growth capital isn't going to solve the problem. Instead, this will demonstrate there is a commercially viable solution for deploying capital into this segment of the market, creating opportunities for other investors to follow.

To understand the broader implications this model would have across the Australian economy, an in-depth analysis was conducted using Strategy& economy-wide modelling. This simulates a change in equity investment into the economy and the consequential impact across gross domestic product, jobs, wages, and household consumption (See **Appendix B** for details on the model).

This model assumes that 75% of ABGF's capital is "new". That is, 25% of ABGF's capital is replacing existing equity that would have already been deployed into the Growth Economy. And so, of ABGF's $540 million, $405 million is considered "new".

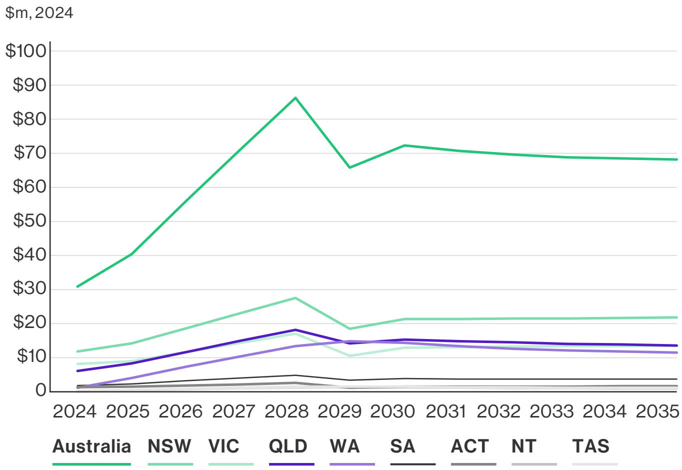
The model also assumes a one-time, five-year investment period. However, ABGF's capital is evergreen and will be reinvested back into the Growth Economy after the initial investment period ends. This continuous recycling of capital will have a compounding effect on the economy. Therefore, this model provides a conservative estimate of the impact of ABGF's "first wave" of capital deployment.

GDP

With an injection of $405 million of new equity, an additional $544 million in net present value (NPV) terms will be realised in additional gross domestic product (GDP). This is achieved over the initial five years of investment, with gross state productivity (GSP) being proportionate to the size of each state. Beyond the initial five years of investment, this approximately equates to an additional $70 million of GDP annually.

When the model considers a second round of investment (which is a closer simulation to ABGF's evergreen investment model), GDP would rise by an additional $726 million over a ten year period, approximately stabilising at an additional $110 million per year beyond the initial ten year period.

FIGURE 8A: GDP AND GSP IMPACT ON INVESTMENT



[1] Assumes 75% of ABGF $540m is 'new money' that wouldn't have otherwise been available.
[2] Results show the impact against the base case (i.e. no investment). Any positive result represents an improvement to the economy.
[3] NPV uses a discount of 5%. Source: Strategy& analysis.
[4] Figures are in real terms.

Proving there is a commercially viable model to invest in the Growth Economy will attract more investors. It will also lead to greater growth and prosperity across the Australian economy through improvements in GDP, jobs, wages and household consumption.

ABGF Portfolio Company: INSKIN Cosmedics
Maria Enna-Cocciolone (INSKIN Founder and CEO) and Ghazaleh Lyari (ABGF Co-Head of Investments)

Employment

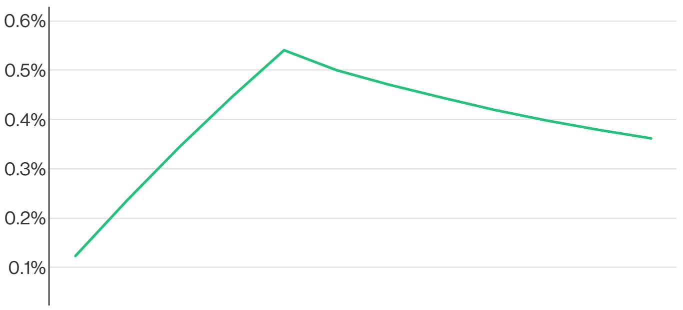
The injection of additional capital will lead to the creation of more jobs and an increase in wage growth by 0.4%. Higher wages contribute to the improvement in household consumption, and are an important indicator of Australia's economic prosperity.

Household consumption

Australian households will directly benefit from the injection of additional capital into the Growth Economy. The additional investment results in a strong improvement in household consumption across each state. The value of this additional consumption is estimated at $306 million in NPV terms.

FIGURE 8B: WAGES GROWTH

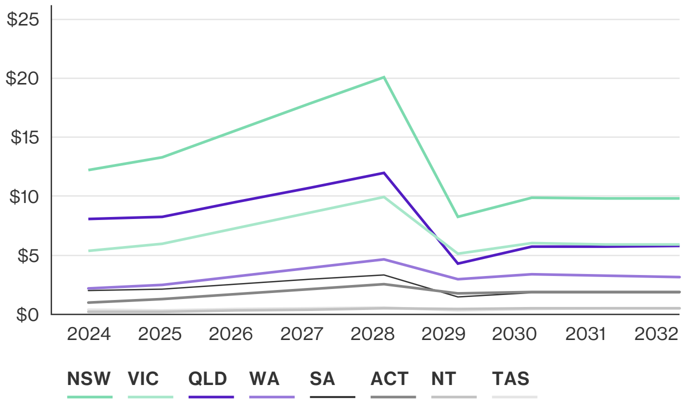
%, 2024



Note: Results show the impact against the base case (i.e. no investment). Any positive result represents an improvement to the economy. NPV uses a discount of 5%. Figures are in real terms. Source: Strategy& analysis.

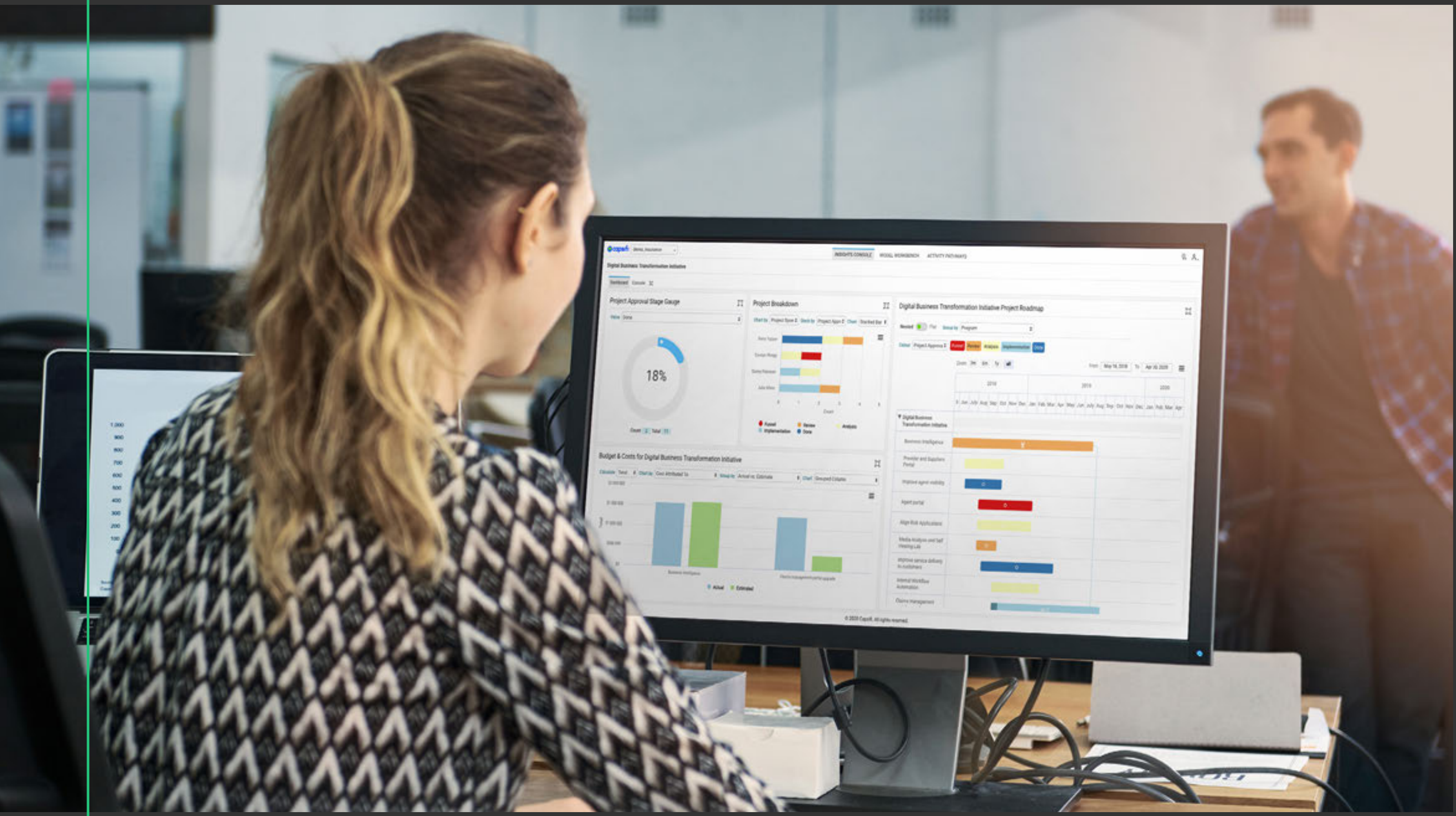
FIGURE 8C: HOUSEHOLD CONSUMPTION

$m, 2024



Note: Results show the impact against the base case (i.e. no investment). Any positive result represents an improvement to the economy. NPV uses a discount of 5%. Figures are in real terms. Source: Strategy& analysis.

Given the historically low levels of investment into Australia's Growth Economy, it is unlikely that an alternative model for investment exists locally. Therefore, consideration should be given to how other economies around the world have tackled this challenge.



ABGF Portfolio Company: Capsifi
Enterprise architecture software

SECTION 9

There is a precedent for growth capital investment

SECTION 9

There is a precedent for growth capital investment

The ABGF model is specifically designed to meet founder equity needs and investor financial returns. The model is based on a proven approach from over a decade of institutional learnings and experience in the UK, and more recently Canada.

Proven models in the UK and Canada

The UK Business Growth Fund (BGF) and Canadian Business Growth Fund (CBGF) have a robust record of supporting business growth, resilience, and profitability in their respective markets.

In the UK, BGF has been a trailblazer in providing growth capital to high-growth businesses across the UK and Ireland. Established with a clear focus on patient capital, the BGF has invested over £4 billion in more than 600 companies since it was established in 2011.

BGF's approach has fostered substantial economic contributions and job creation, proving itself a pillar of business development support in the UK, and has also delivered for shareholders via an attractive ROI and a sustainable dividend yield.

More recently, CBGF was established to invest in Canadian growth businesses. By the end of 2023, the fund had injected over $375 million into more than 31 Canadian companies, aiding in the creation of thousands of jobs and the execution of dozens of follow-on transactions.

These efforts underline each Fund's commitment to nurturing a supportive ecosystem for SMEs, particularly during fluctuating market conditions.

The ability to provide sustained support and invest through market cycles is a key reason behind the success of this model. This approach ensures companies can overcome temporary economic disruptions, enabling them to plan with confidence. As BGF notes, its "ability to provide truly long-term funding that flexes to the needs of the business (...) is something few investment firms can offer". This is as true now as it was in 2011 when it was first established.

"We strategically selected the Australian Business Growth Fund as our equity partner to leverage their expertise in scaling high growth businesses and their extensive network. This partnership fortifies our dominant presence in the sun protection market worldwide, empowering us to accelerate our expansion into new international markets."

Johanna Young – Founder and CEO, Solbari

ABGF Portfolio Company: Solbari
Ghazaleh Lyari (ABGF Co-Head of Investments) and Johanna Young (Solbari Founder and CEO)

Measuring ABGF's success

The success of ABGF will be measured through a combination of financial, non-financial and economic metrics, reflecting its dual mission of generating commercial returns and fostering economic growth.

From a financial perspective, ABGF will focus on the effective deployment of capital and achieving favourable commercial returns to shareholders. This will be achieved across metro and regional areas of Australia, and through a responsible and sustainable investment approach.

Monitoring the underlying growth of portfolio companies is another vital aspect. This includes evaluating revenue growth, profitability, market share expansion, and geographic reach of the investment portfolio. The goal is to attain the right type of growth and performance that is both responsible and sustainable. To achieve this, ABGF measures key growth indicators in the areas of environmental, social, and governance (ESG) outcomes, and provides portfolio companies with toolkits tailored to their specific ESG priorities. These indicators reflect the responsible investment focus of ABGF on supporting investments to become sustainable as they grow their businesses over the long-term.

Economic metrics are equally important in assessing ABGF's success. Job creation is a significant measure, with a focus on the number of jobs created and supported within investee companies; as is the diversity of the workforce. Tracking total employment numbers and growth, staff engagement and diversity will provide a clear indication of the fund's impact on jobs creation.

By focusing on these metrics, ABGF ensures that its investments not only yield financial returns but also significantly contribute to long-term economic sustainability and growth across Australia. Balancing financial prudence with socio-economic impact underpins the Fund's commitment to fostering a robust and resilient economy.

Demonstrating the commercial sustainability of an alternative investment model that provides the type of capital Growth Economy businesses seek is the first step towards attracting more investment funds into this asset class and begin to meaningfully address the equity funding gap. This will deliver a more robust future for the Growth Economy with increased job opportunities, heightened economic activity, and enhanced prosperity for all Australians.

This approach is not just about providing equity. As with BGF, CBGF and now with ABGF, it is about nurturing an environment where innovation thrives and growth businesses can scale.

"When HSBC and the other founding shareholders started the UK Business Growth Fund (BGF), we knew a different model of investment was required. We saw a genuine opportunity for scaling businesses to access capital and long-term support to help them grow. I've witnessed the results as BGF has supported many successful businesses over the years. The Australian Business Growth Fund is taking a similar approach and it's already delivering."

James Chew – Group Head of Regulatory Strategy, HSBC

It's a new world

BACKING AUSTRALIAN BUSINESSES TO THRIVE

APPENDIX A

Primary research methodology

Primary research was conducted by East&Partners to determine the funding landscape for businesses in the Growth Economy. A total of 3,595 businesses were initially interviewed and provided details on their business growth, external funding mix and barriers to access funding. Of these businesses, only those that were growing, had static growth, or stated they would grow with equity funding, continued to the full survey.

2,023 businesses completed the full survey after having met the sample requirements.

The breakdown of businesses by revenue size is summarised below:

- $2 – $20 million turnover (N = 1,212);
- $20 – $100 million turnover (N=811).

East&Partners Growth Economy survey methodology

SAMPLE SELECTION	Businesses were selected on a randomised, nationally representative basis aligning with ABGF's core framing requirements – Australian headquartered, annual turnover between $2m – $100 million, and with a business age greater than two years old.
INTERVIEW METHOD	These interviews were conducted by East&Partners' in-house primary researchers using a blend of Teams and Zoom calls following a structured, jointly developed, interview questionnaire over the six-week period ending January 2024.
INTERVIEWEES	Interviews were conducted directly with the key internal individual, such as the CEO/Founder/CFO/Finance Director/SME owner with primary responsibility for the business financing and banking decisions.
KEY QUESTIONS	Key questions regarding access to debt and equity capital, challenges in achieving growth, key pain points in current funding options and potential for future equity investment and potential benefits of same were asked.

APPENDIX B

Economic modelling methodology

Economic modelling was conducted by Strategy& (part of PwC) to understand the impact of equity funding on the broader economy, using a computable general equilibrium (CGE) model of the Australian economy, based on the Victoria University Regional Model (VURM). This model is based on real economic data and considers major sources of economic activity such as consumption, investment, government activities and exports.

Two 'shocks' were applied to the model to determine the impact of the proposed change. These shocks were:

1 – capital injections by ABGF based on industry revenue contribution

2 – productivity improvements derived from revenue growth expectations

Two rounds of investment were considered for both scenarios, an initial investment (2024 to 2028) and a further investment five years later (2029 to 2033). In the initial investment round, 75% of ABGF's investment was considered as 'new money' that wouldn't have otherwise been available within the economy. In the second round, 50% of ABGF's investment was considered 'new money'.

The results show the difference from the status quo base being the economy without ABGF's investment. This is the economy without the investment. Therefore, even results that diminish, if positive, still represent a positive impact on that indicator as a result of ABGF's investment.

The model output shows the effects of ABGF investment on the following metrics:

- Gross Domestic Product and Gross State Product;
- Investment;
- Jobs and wages;
- Household consumption.

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