Deloitte.

2005 Q3

Corporate Finance

The South African

Private Equity Confidence Survey

SAVCA
SOUTHERN AFRICAN VENTURE CAPITAL
AND PRIVATE EQUITY ASSOCIATION

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Introduction

Welcome to the second publication of the South African Private Equity Confidence Survey (“PECS”), conducted by Deloitte in conjunction with the Southern African Venture Capital and Private Equity Association (“SAVCA”) amongst a population of over 300 investment professionals in the Private Equity industry across South Africa.

Questionnaires are sent to different investment professionals within the same organisation. The publication summarises the results of the 12 month forward looking sentiment in the industry in Quarter 2 and Quarter 3 2005.

Key Findings

- Positive and stable economic climate
- Increased investment opportunities, competition for investments, volume of transactions and average deal sizes
- Top sectors of interest remain services, manufacturing and telecommunications
- Majority of professionals expecting to be net buyers of businesses
- Superior investment returns anticipated from private equity funds
- Funds to be more empowered
- BEE still expected to generate more opportunities and be a requirement in the majority of deals

Summary Results

Economic and Market Climate

The industry continues to echo a sustained positive sentiment in the overall economic climate during the next 12 months, with 96% of respondents during Q3 expecting the climate to stay the same or improve from prior periods (Q2: 89%). Only 4% of respondents anticipating a decline in the overall economic climate (chart 1).

Funding

Relatively unchanged from Q1 through Q3, 56% of respondents intend to raise a new fund during the next twelve months (chart 2). Most respondents expect the ease of raising funds to remain unchanged from past periods, with a decline in respondents (Q2: 37% to Q3: 28%) predicting the raising of new funds to be more difficult (chart 3). This is further positive in lieu of the continued expected increase in investment opportunities and competition for new investments in the market which requires the availability of funds for investment.

The predominant source of funding continues to be from Government / Developmental Funding Institutions and Pensions and Endowment funds. The contribution from corporates continues its upward trend from Q1 to an expected 9% in Q3. This may indicate an increase in investor confidence in Private Equity from the private sector (chart 4).

From a geographical perspective, South Africa remains the most popular source of potential funding, albeit down to 49% in Q3 from 57% in Q2. The Europe and US have remained relatively consistent. Other sources of funding listed in Q3 were the Middle East and Asia (chart 5).

The vast majority (combined 94%) of respondents predict that the time to invest current funds will be less than 4 years. There has been a marked decline in the "more than 4 years" category to only 6% of respondents in Q3, from the 21% in Q4 2004 (chart 6). A decrease in the time to invest a fund generally indicates that there are more investment opportunities in the market.

The current understanding and attitude of institutions to the PE industry is still assessed as improving by most of the respondents in Q3, continuing the trend established in prior surveys (chart 7).

Investments

The industry interest barometer (chart 8) shows the majority of the investment focus still falling within the manufacturing and service sectors followed by telecoms.

The types of deals expected during the next twelve months indicates a sharp decline in the last two quarters in particular the replacement and buy out type of deals (down to 4% from a high of 52% in Q1). Expansion and development type deals are now overwhelmingly expected to be the most popular at 68%, and continuing an upward trend. Disappointingly, the industries appetite for start up, early stage and specifically seed capital types of deals remains low (chart 9).

Competition for new investment opportunities is still expected to be on the increase according to 76% of survey participants with a higher number of respondents in Q3 (24%) as compared to Q2 (14%) of the opinion that competition for new investments has stabilised (chart 10).

Only 2% of respondents indicated that the entry multiples on transactions will decrease, with 57% of respondents still expecting a further increase (chart 11).

Positive deal flow is again anticipated with 53% of respondents anticipating that transaction volumes will increase during the next 12 months. The proportion of respondents expecting a decrease in volumes is low at only 6% of respondents (chart 12).

Bigger deals are on the cards, with 57% (the highest to date) of respondents expecting the average deal size to increase. Stable deal sizes are expected by 39% of participants with the proportion of respondents expecting a decline in average deal sizes decreasing to 4% in Q3 (chart 13).

Complimenting the overall expectation of increased investment opportunities and competition for new investments, 60% of respondents expect to be net buyers of businesses during the next 12 months, be that down from a high of 81% in Q1 (chart 14). Those expecting to be net sellers in the next 12 months remain at similar levels in Q3 (30%) as in Q2 (32%), but up from a low of only 12% in Q1.

The expectation of debt finance availability for transactions remains high with 71% of respondents expecting this to increase (chart 15).

Exits

The price of exit valuations is expected to continue to increase as predicted by 65% of respondents (chart 16), despite the expected increase of respondents becoming net sellers (chart 14). Consistent with the expectation that a greater proportion of respondents expect to be net sellers of investments, the results depicted in chart 17 also show an increase in the proportion of respondents expecting an increase in exit volumes from 49% in Q2 to 60% of respondents in Q3. The trend in exit mechanisms is becoming more pronounced with trade sales remaining the most popular envisaged exit mechanism with a continued disappointing appetite for IPO's (chart 18).

Investment lifecycles are on the increase with fewer respondents in Q2 and Q3 compared to Q1 expecting a lifecycle of two to five years and more respondents in Q2 and Q3 expecting a greater than five year investment cycle (Chart 19). This may well be indicative of investments performing well over longer periods, resulting in an increased holding period.

Performance

The prognosis for performance of investee companies relative to expectations has tempered somewhat with 81% of respondents now expecting performance in line with expectations up from 66% in Q2 (chart 20).

Respondents' expectations of performance are however still extremely bullish with the overwhelming majority expecting the combined value of their investee companies to increase in the next 12 months (chart 21).

BEE

The drive for the achievement of BEE in South Africa is also evident in the industry. Results show a continued upward trend towards black controlled funds for 39% of respondents, up from 32% in Q2 and a low of 16% in Q4 2004. Levels of black empowered funds have dropped (Q1: 53% to Q3: 21%), presumably due to substitution for more empowered funds. Black influence is following a similar upward trend with expectations of no black involvement at a low of 5% (chart 22).

The recognition of BEE as a driver of deals is entrenched with 60% of survey participants responding that BEE is expected to be a requirement in more than 75% of their deals (chart 23). BEE is still acknowledged as generating more opportunities by 79% of respondents, up from 71% in Q2 (chart 24).

Other

For a private equity professional the year ahead shows that the majority of time will be spent on new investments (37%) according to Q3's results, and 26% on portfolio management. This is in line with the prior survey findings.

Investors

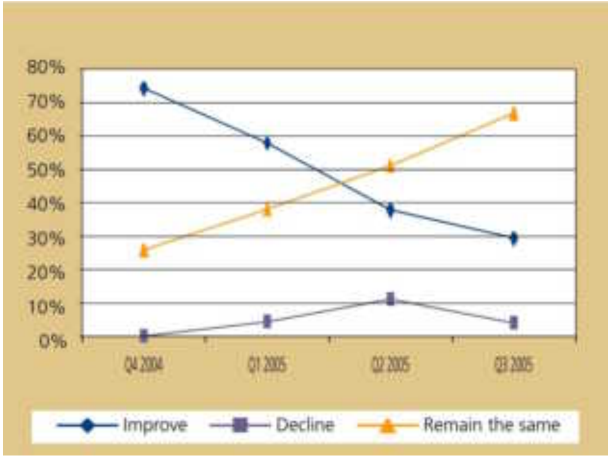
Outperformance relative to the JSE (chart 26) as well as superior risk-adjusted returns provided by private equity professionals remains the dominant view of investor respondents (chart 27), however the relative allocation of funds expected for the asset class shows a less bullish view that in Q2 (chart 28). The combined view of 83% of respondents does however indicate that the allocation of funds will be increasing or remaining the same. This is in line with the percentage of current allocations of funds to private equity which shows a positive trend in the 2.5% to 5% and above 5% categories (chart 29).

For capital committed to private equity, not surprisingly, there is also an expected increase in the percentage that will be allocated to BEE funds as can be seen from chart 30.

Lack of appropriate risk adjusted and lack of liquidity are still the two most common constraining factors identified for private equity by investors (chart 31).

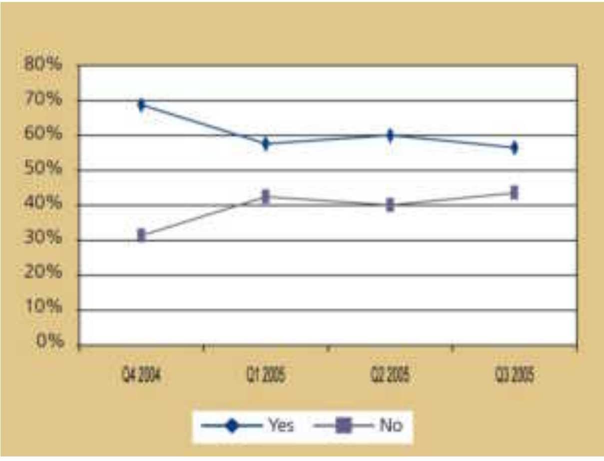
General Economic Climate

1. During the next twelve months, I expect the overall economic climate to:

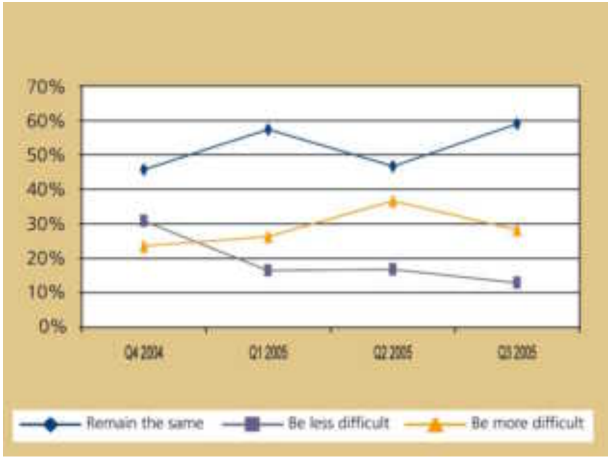


Funding

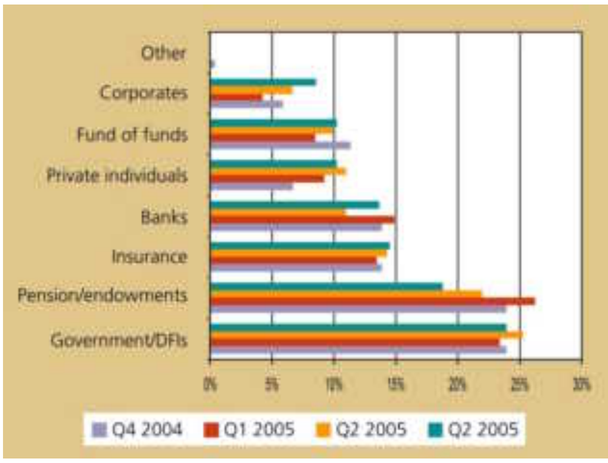
2. Over the next twelve months we plan to raise a new fund:



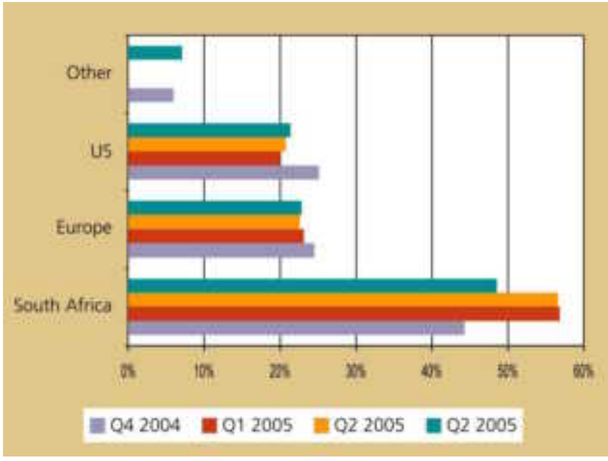
3. Over the next twelve months we expect raising new funds for investment to:



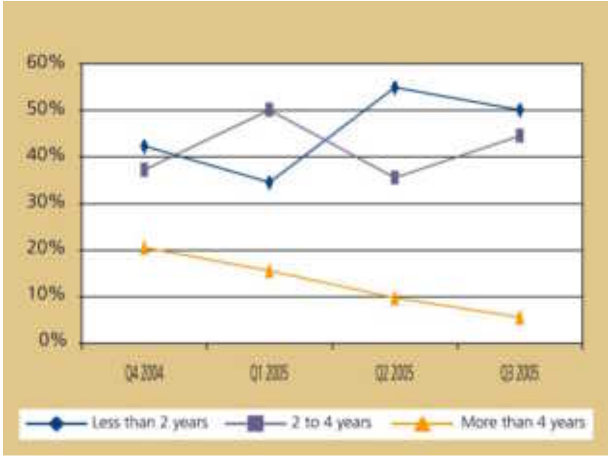
4. If we intended to raise funds within the next 12 months, we would raise capital from the following source of third party funding:



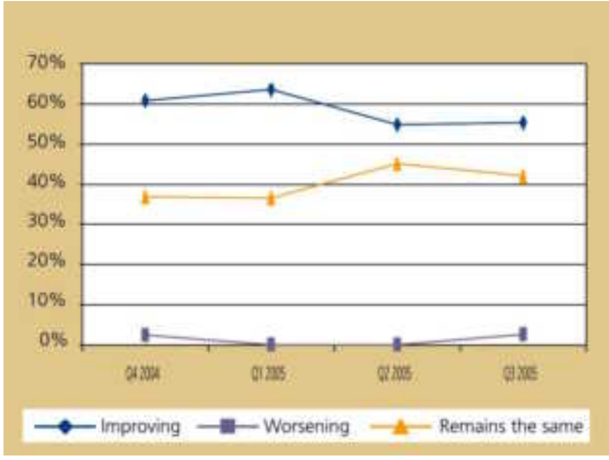
5. If we intended to raise funds within the 12 months, we would raise capital from the following geographical source:



6. I expect the time it will take to invest my current fund to be:

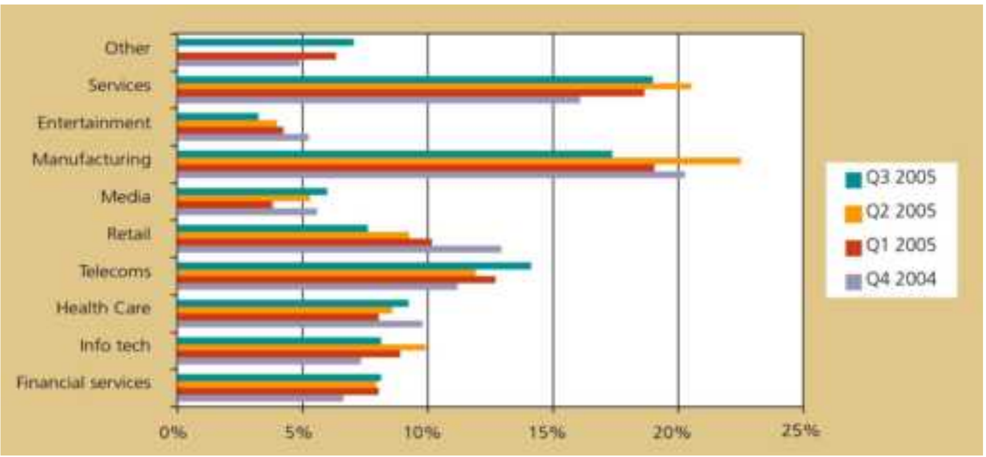


7. Currently, I feel that the understanding and attitude of institutional investors towards the PE / VC industry is:

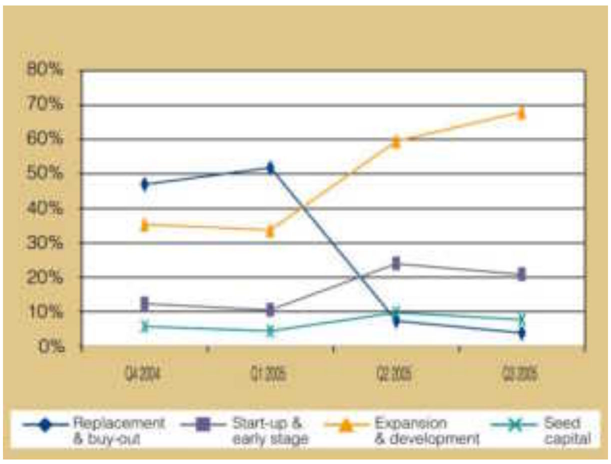


Investments

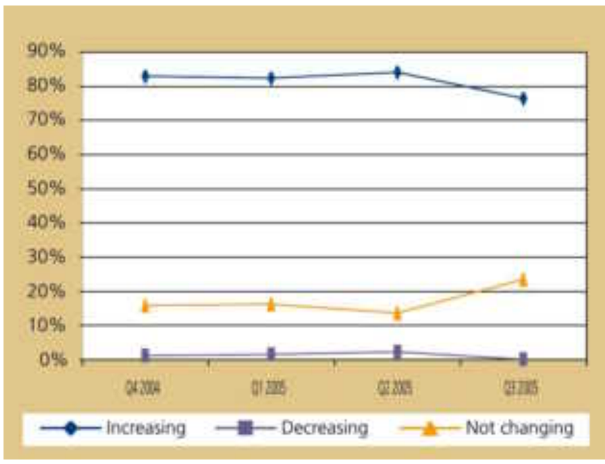
8. Over the next 12 months I expect to focus on opportunities in the following sectors:



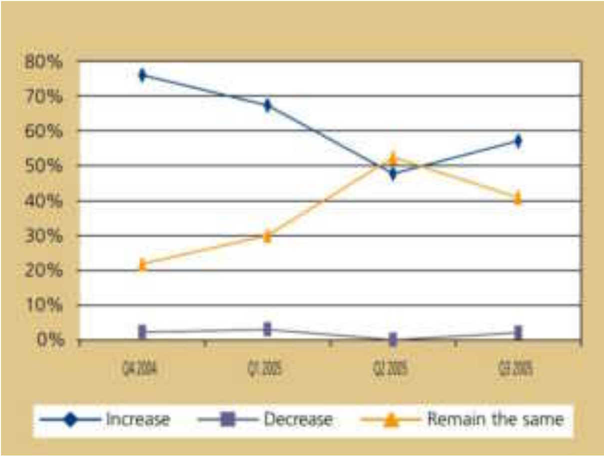
9. I am currently looking at the following types of deals:



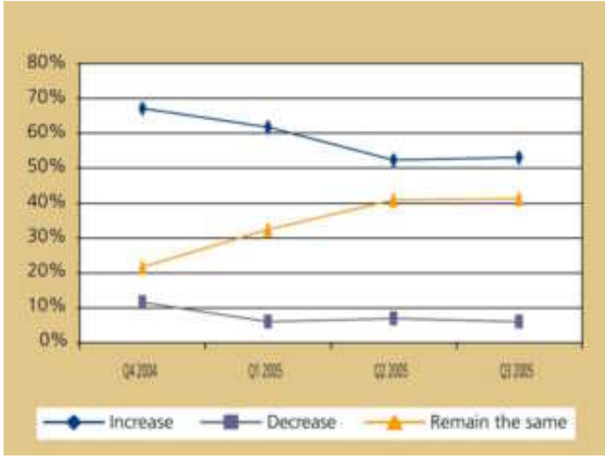
10. At the present time, competition for new investment opportunities is:



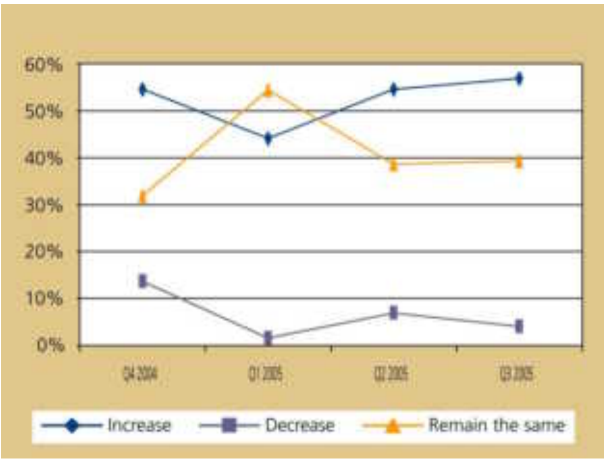
11. Over the next twelve months I expect entry multiples on transactions to:



12. Over the next twelve months I expect the volume of transactions to:

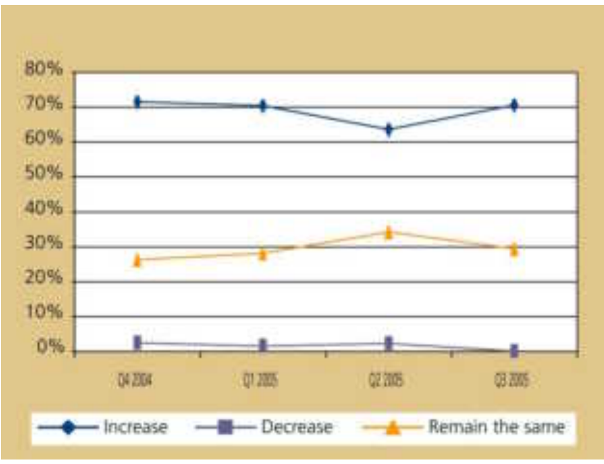


13. Over the next twelve months I expect the average deal size to:



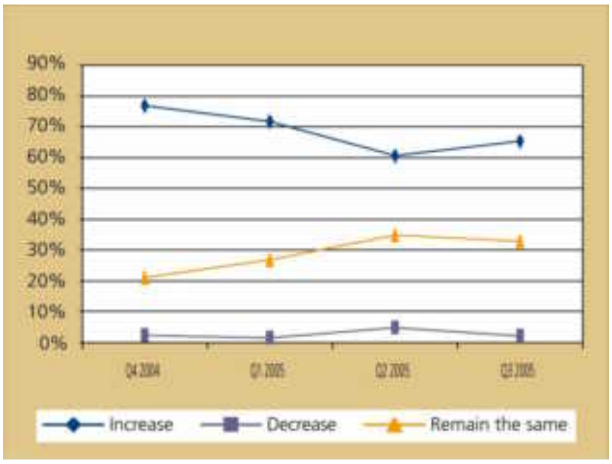
14. In the next twelve months I expect to be a net buyer or net seller of businesses:

15. I expect the availablity of debt financing for transactions to:

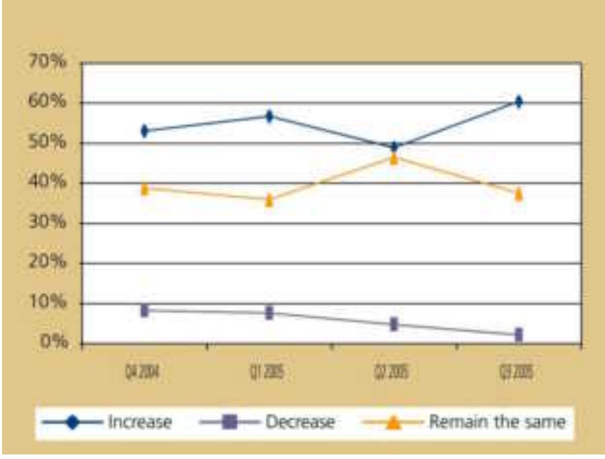


Exits

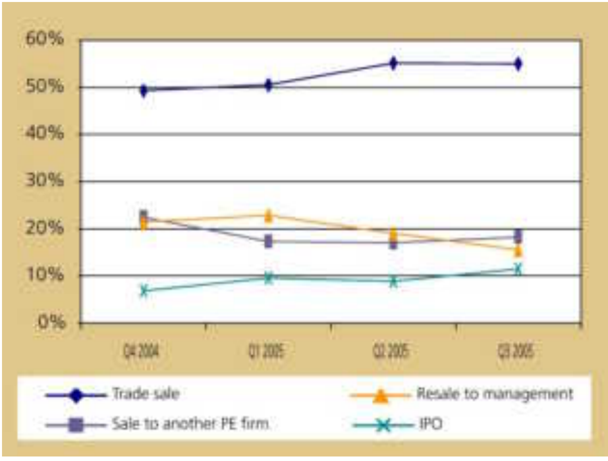
16. During the next twelve months, I expect exit valuations to:



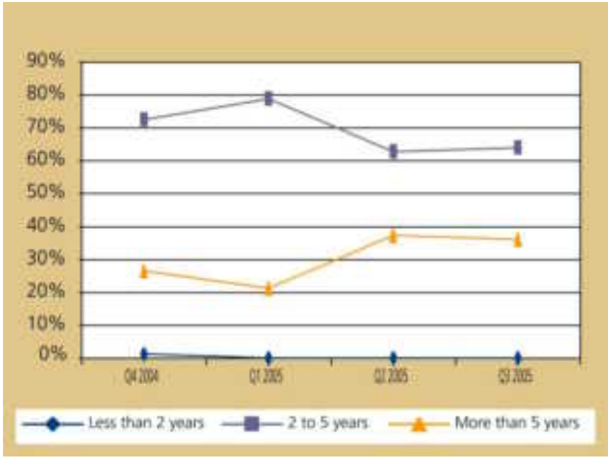
17. During the next twelve months I expect the volume of exits to:



18. During the next 12 months, we expect to exit investments by:

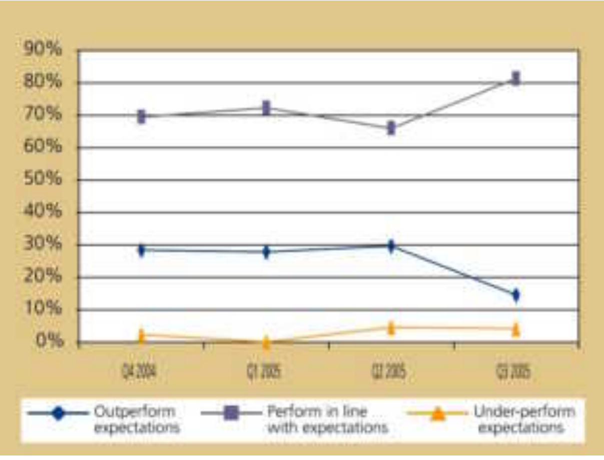


19. I expect the average lifecycle from initial investment to exit for investments made in 2004 to be:

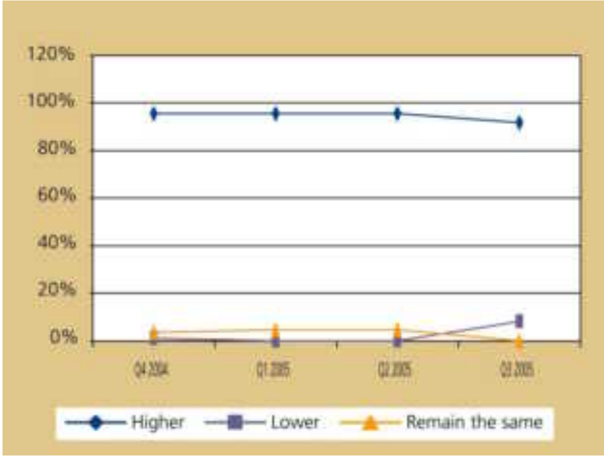


Performance

20. Over the next twelve months I expect the relative financial performance of our investee companies to:

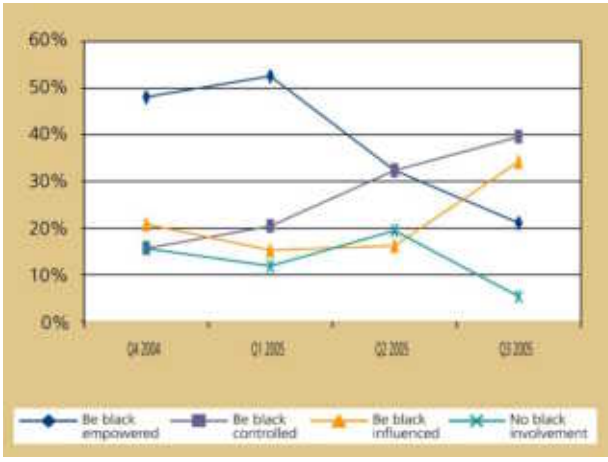


21. Twelve months from today, I anticipate the combined valuation of all portfolio companies in which we are invested today, relative to current value, to be:

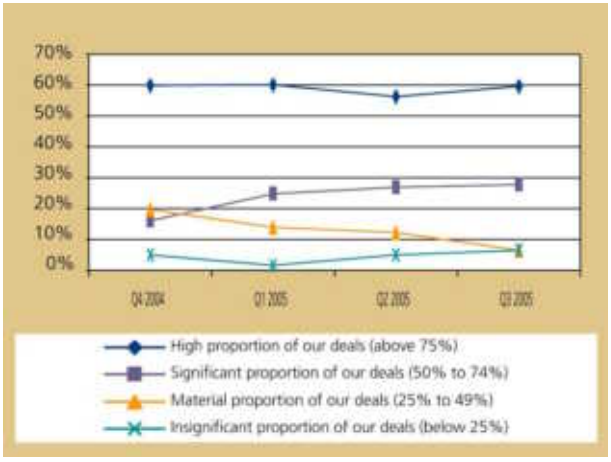


BEE

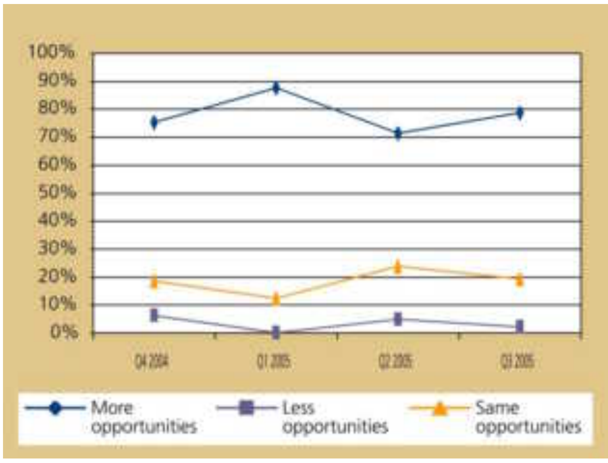
22. During the next twelve months we expect our fund to:



23. During the next twelve months we expect BEE to be a requirement:

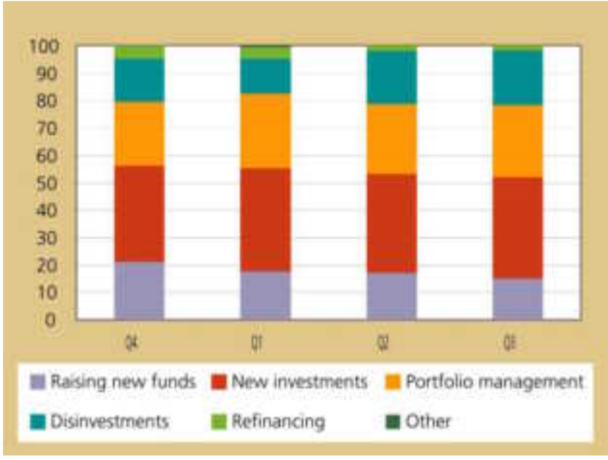


24. For our business, BEE will generate:



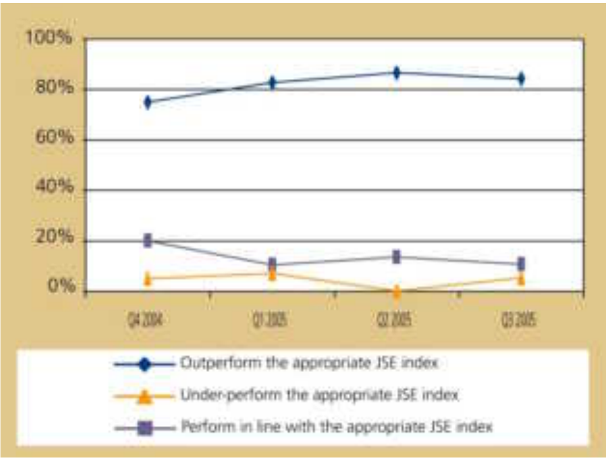
Other

25. During the next twelve months, we expect to spend the majority of our time focused on:

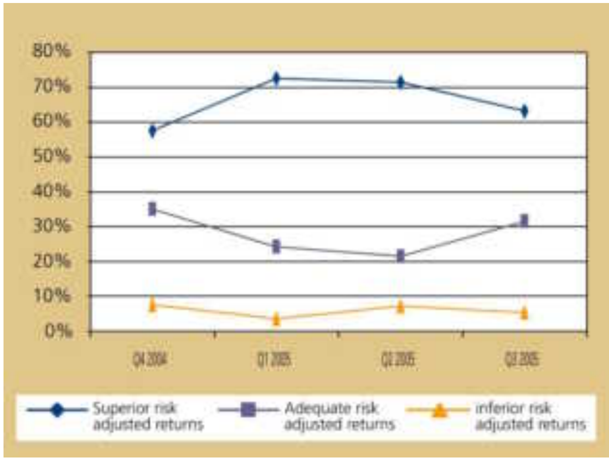


Investors

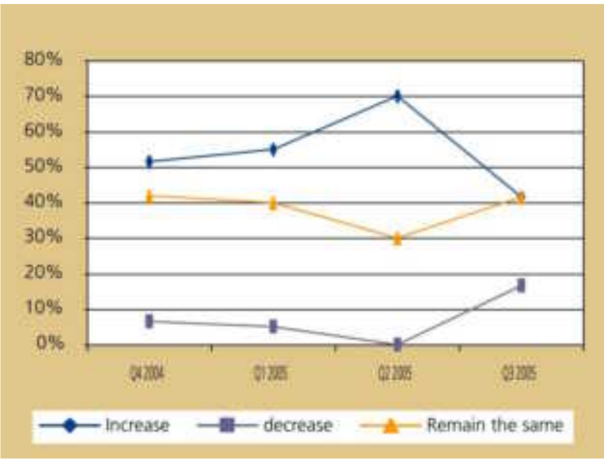
26. My current medium-term view is that PE / VC funds will provide returns that will:



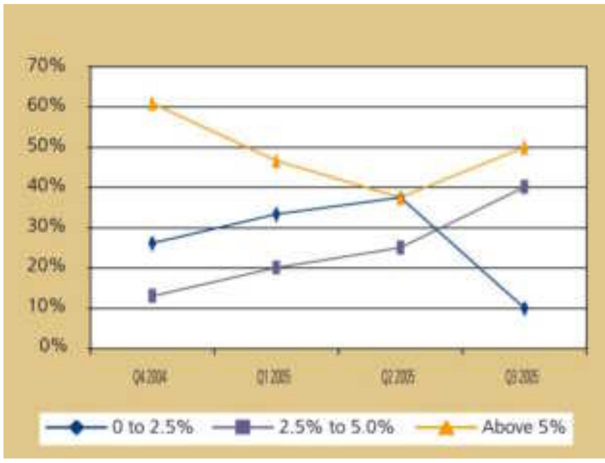
27. My current medium-term view is that PE / VC funds will provide:



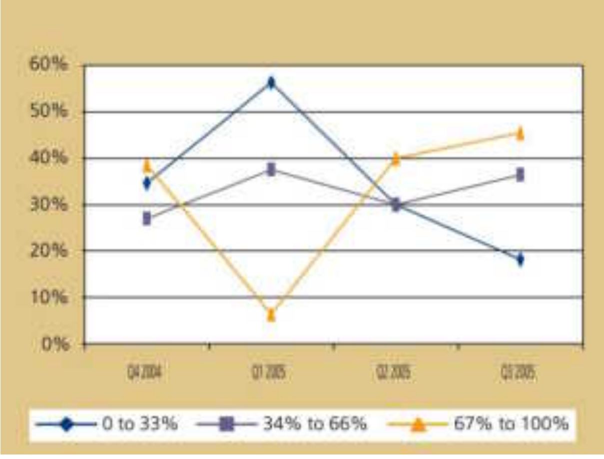
28. During the next twelve months we expect our allocation (% of total funds) to PE / VC funds to:



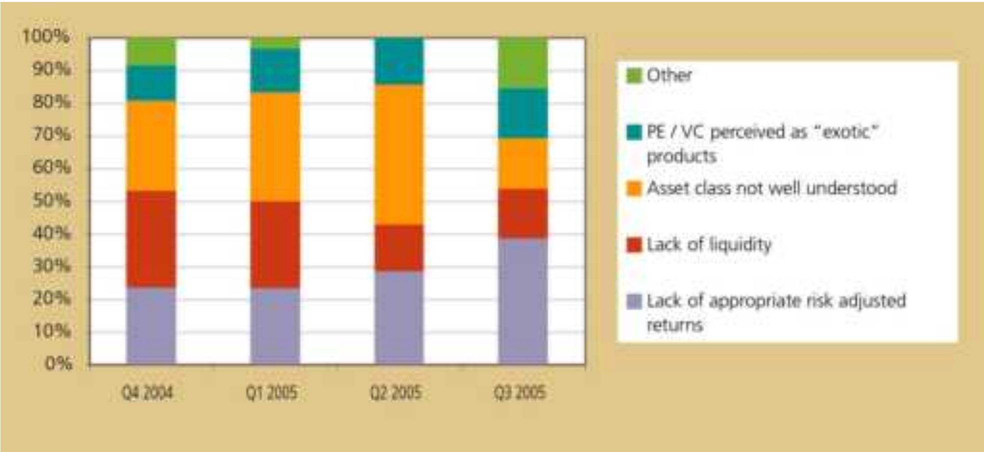
29. Our current allocation to PE / VC funds are:



30. Of our funds committed to PE / VC funds during the next twelve months, investment in BEE funds will be:



31. I expect the following to be contraining factors during the next twelve months for investing in PE / VC funds:



About PECS

The Deloitte PECS provides a comprehensive snapshot of the venture capital and private equity industry's expectations for the next 12 months, and acts as an indicator of changing confidence levels in:

- economic climate
- deal activity
- availability of funding and investment focus.

The results produce a forward looking measure of the overall sentiment in the South African Venture Capital and Private Equity community, which is extremely relevant to immediate deal flow. This survey, is modelled on similar quarterly surveys conducted in 16 other developed and emerging economies and from a South African perspective, will initially be conducted on a quarterly basis and published semi-annually. PECS will further facilitate comparisons of trends and views expressed by the global venture capital community with our domestic marketplace. The surveys were conducted amongst a population of approximately 300 private equity investment professionals in South Africa.

Other countries and regions where Deloitte prepares PECS include:

United Kindom	Germany/Austria/Switzerland
France	Canada
Australia/New Zealand	Israel
Benelux Countries	Czech Republic
Slovakia	Hong Kong/China

Deloitte Contacts

For further information about this survey or to find out more about Deloitte's Corporate Finance team please contact one of the specialists listed below. Suggestions for issues to be addressed in future Private Equity Confidence Surveys are welcome.

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About SAVCA

SAVCA was founded in 1999 and is the industry association representing venture capital and private equity firms in South Africa. SAVCA presently has 61 full members and 25 associate members, representing 350 professionals in the industry with over R45 billion of assets under management. For more information, or to become a full or associate member of SAVCA, please contact:

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Notes

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Designed and produced by the Studio at Deloitte, Johannesburg. (ZA/5921)

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