Private equity

on the rise locally and into Africa

By Vivienne Fouché

As an asset class, private equity consists of equity securities and debt in operating companies that are not publicly traded on a stock exchange. Investors make investments directly into private companies and/or conduct buyouts of public companies that result in a delisting of public equity.

Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions and strengthen a balance sheet. More and more capitalised players are raising funds and positioning capital across South Africa, while a pattern also seems to be emerging of private equity investors entering into African opportunities, as potentially good returns over the next three years are envisaged in this space.

Doing well and breaking into Africa

The *RisCura-SAVCA South African Private Equity Performance Report*, released in August, confirms that the private equity asset class continues to deliver a vibrant performance which also compares favourably with listed equity. In addition, the report includes a discussion of the growing role of Africa in the private equity environment.

Erika van der Merwe, SAVCA CEO, says, "In our view, the resilience of private equity returns is in part owing to the long-term focus of the industry, and its strategic and active partnerships with the companies in which fund managers invest.

"Moreover, South African private equity fund managers increasingly set their sights on benefiting from growth across the African continent, whether by way of cross-border deals which add to their portfolio of investments, or

through providing their investee companies with the capital needed for operational expansion into new territories. Institutional investors in various markets now recognise the valuable exposure that private equity can give them to African growth, in a way that ensures they have a positive, developmental impact in the region." Richard Pople, managing director of Xigo, a specialist in selling privately owned companies, adds, "Africa is an exciting investment destination at present. There is considerable interest in the large consumer market that the continent represents, and investors are looking for ways to mine it. We have an extensive database of potential buyers for businesses in Africa and we have noticed a marked increase in local and international interest over the past few months."

Changing international attitudes towards investing in Africa are succinctly summed up in cover stories of *The Economist*. The publication famously portrayed Africa as 'The hopeless continent' in its 13 May 2000 edition. A decade later, *The Economist* had changed mind-set completely, with the positive 3 December 2011 cover 'Africa rising' and even more recently, its 2 March 2014 cover reading 'Aspiring Africa'.

Africa as a continent has a substantial demand for goods and services. South Africa with its solid infrastructure, highly advanced financial system and well-regulated economy, is often a springboard for expansion into the rest of Africa.

"This interest in Africa can provide a tempting opportunity for private business owners to sell their companies to international acquirers," notes Pople. But he cautions that sellers should not be too hasty in accepting offers.

"A business needs to be carefully and strategically positioned to maximise its selling price. We have multiple clients who approach us after having received an unsolicited offer, and a speculative buyer – someone who makes you an offer without having understood the strategic benefits to the acquisition – is unlikely to be the best buyer.

"This is because acquirers should not buy your business based on its history, but rather on its future potential. A critical aspect of selling a business is correct valuation. We work with prospective sellers to produce a unique synergy business plan which outlines what the business will look like in three years' time under new ownership. By doing the proper ground work, and illustrating the potential future of the business, it is possible to position the company for an optimal selling price."

Facts and figures

The latest RisCura-SAVCA *South African Private Equity Performance Report* shows that private equity returns for the ten-year period to March 2014 were at 21.2 per cent (annualised internal rate of return, net of fees).

These returns compare with the 19.6 per cent yielded by the JSE's All Share Index over the same period, and the 20.5 per cent tracked by the JSE Shareholder Weighted Index. Private equity trailed the FINDI, which returned 23.0 per cent.

Van der Merwe comments, "These latest numbers confirm the returns-boosting role of private equity in a diversified institutional portfolio and especially so in a global context where institutional investors are seeking sustainable avenues for shoring up performances. The performance is also one of the reasons why South African-based private equity funds have reported success in their recent fundraising programmes."

In addition, the *SAVCA-KPMG Private Equity Industry Survey 2014* shows that South African funds raised R27.3 billion in 2013, helping to take funds under management in the industry to a new high of R162.2 billion.

"We are seeing a new wave of private equity funds being formed and expect more deal flow in the near future as capital is deployed by these funds. This is in the context of a market that has seen recovery since the 2008 financial crisis," says Rory Ord, head of private equity at RisCura.

"This recovery – and indeed resilience – is evidenced by the fact that that private equity returns are holding their ground against JSE-listed equity returns, despite the listed market hitting record highs," Ord says. The resilience of private equity returns is in part owing to the long-term focus of the industry and its strategic and active partnerships with the companies in which fund managers invest.
In addition, as outlined, South African

The Southern African Venture Capital and Private Equity Association (SAVCA) is the industry body and public policy advocate for private equity and venture capital in South Africa, representing about R160 billion in assets under management. SAVCA promotes Southern African private equity by engaging with regulators and legislators on a range of matters affecting the industry, providing relevant and insightful research on aspects of the industry, offering training on private equity and creating meaningful networking opportunities for industry players.

The RisCura-SAVCA *South African Private Equity Performance Report*, released quarterly, tracks the performance of a representative basket of South African private equity funds. Its purpose is to provide stakeholders in South African private equity with more transparency into historic returns and a way to benchmark private equity funds' performances. All private equity returns shown in the report are net of all fees and expenses, and are computed in South African rands as well as US dollars.

private equity fund managers increasingly set their sights on benefiting from growth across the African continent, whether by way of cross-border deals that add to their portfolio of investments, or through providing their investee companies with the capital needed for operational expansion into new territories.

"Institutional investors in various markets now recognise the valuable exposure that private equity can give them to African growth, in a way that ensures they have a positive, developmental impact in the region," van der Merwe says.

"For these institutional investors, whether pension funds, development finance institutions, sovereign wealth funds or family offices, this is an opportunity to do good while reaping financial benefits."

With a population of over one billion, the continent is the world's second most populous after Asia. It is also a very youthful population: it has been estimated that by 2040, Africa will have the world's largest working population.

More and more Africans are moving into the ranks of the middle class, notably in the commodity-rich countries, and this is reflected in rising per capita GDP figures as well as mounting disposable income levels. In combination, these factors all speak to Africa's growing appeal as an investment destination.

The Southern African Venture Capital and Private Equity Association (SAVCA) is the industry body and public policy advocate for private