

OVERVIEW

# A viable asset option

**With growing interest from international investors, the sector performs impressively**

**F**unds under management in the SA private equity space topped R162bn at December 31 2013, according to the 2014 KPMG and Savca Venture Capital & Private Equity Industry Performance Survey. Growing investor interest from the Middle East, North America and Europe has helped the sector achieve 11,8% compound annual growth over the past 14 years.

"The survey conveys responses from over 70 firms, representing 80 funds, including the Public Investment Corp," says Southern African Venture Capital & Private Equity Association (Savca) CEO Erika van der Merwe.

There are three main stakeholders in the private equity space. The big institutional investors (limited partners) allocate their capital to the second stakeholder (private equity funds) which, in turn, invests in targeted investment opportunities (portfolio or investee firms).

## WHAT IT MEANS

**SECTOR BOASTS 11,8% COMPOUND ANNUAL GROWTH**

**BUT LACKLUSTRE ECONOMIC ACTIVITY A CONCERN**

"Private equity funds tend to have a 10-year life, and investments within a fund tend to be held for between five and eight years, depending on market conditions and the performance of the individual investments," says Rory Ord, head of independent valuations at RisCura.

Their objective is to achieve an internal rate of return exceeding 20% and to double the invested capital over the life of the deal. "Investors demand returns in excess of those generated by public markets as compensation for the lack of liquidity in the sector," says Garth Willis, a partner at Capitalworks. "The industry benchmark is to target annualised returns of 30%, which reflect the risk-adjusted returns demanded by international investors into the emerging market private equity asset class."

Head of corporate relations at Ethos Private Equity, Chelsea Wilkinson, says the combination of having to outperform liquid benchmarks over the long term and the pri-

vate equity incentive structure — where the fund participates in returns only after investors receive their capital back plus a "hurdle" return — delivers an ownership model that aligns investor, fund manager and portfolio company management interests.

It is important to distinguish between venture capital and private equity. Says Van der Merwe: "Venture capitalists get involved at an early stage, sometimes pre-revenue and certainly pre-profit. As a firm develops and becomes established and profitable, it requires growth capital, which is when private equity players become involved."

Numerous private equity deals are completed each year, many of which are listed in the KPMG/Savca report. The largest deal in 2013 was the R4,7bn Bokpoort concentrated solar project. Private equity funds provided 25% of the capital, with the balance funded via debt financing.

Will funds under management in the private equity sector match the 17% growth achieved in 2013 over the medium term? "It is likely that SA equity performance will be lower over the next decade compared to the last. But private equity offers diversification from otherwise concentrated listed markets within an institutional portfolio," says Ord.

Van der Merwe says investor sentiment will play a role in the amount of capital available for new investment. "But though overall economic conditions influence the returns from private equity, the model of careful asset selection and hands-on management is one of the reasons private equity outperforms listed equity over time."

Much hinges on the sector's ability to source new funding. "SA is not as attractive an investment destination as it was, with many international investors switching their attention to the rest of Africa in recent years," says Horizon Equity MD Richard Flett. "Unless local fund managers can mobilise more capital from local sources, the industry may in fact shrink."

Fourie says many funds are in their "harvest" or exit mode at present. But, he says, this should lead to greater private equity

commitments over the medium term as investors recommit their returned capital along with some of their proceeds.

"Private equity gives far better exposure to the emerging African consumer than the listed market," says Van der Merwe.

The industry will continue to grow, thanks to the faith global investors have in the local market, their interest in the African growth story and the renewed interest of private equity in infrastructure projects.

Ord says private equity is also a great accelerant for the economy as firms financed by private equity typically grow revenues, tax receipts and the number of employees faster than listed companies.

And Van der Merwe applauds private equity for filling the gap when traditional funding models cannot perform. "It is a good model for improving governance, helping bring about empowerment and developing the economy," she says. ■



**Erika van der Merwe**  
Private equity gives better exposure to the emerging African consumer