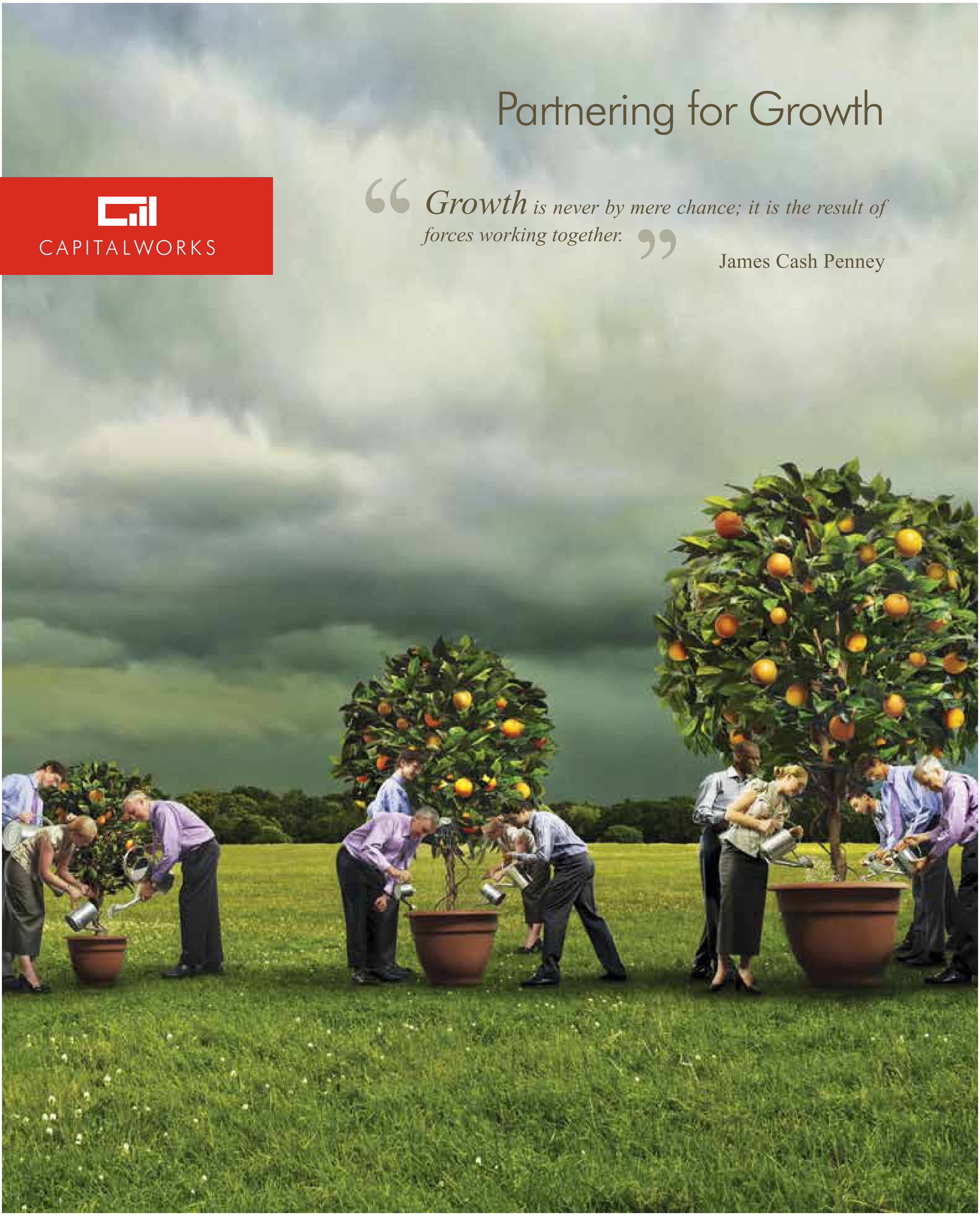
SAVCA

SOUTHERN AFRICAN VENTURE CAPITAL
AND PRIVATE EQUITY ASSOCIATION

THREE DECADES

An account of the rise and establishment of South African private equity

INVESTING FOR GROWTH • INVESTING FOR GOOD



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Foreword

SAVCA Chairman, Dave Stadler

We are very proud to present our industry publication entitled "Three Decades", tracking the development of the South African private equity industry since its inception. Our industry has experienced remarkable growth and change over the years and this publication attempts, for the first time, to crystallise this history and formally honour some of South Africa's private equity stalwarts.

Dave Stadler

It is impossible to reflect on our industry's evolution without considering our country's unique history. South African private equity had a most unusual kick-start in the mid-1980s when wide-scale foreign disinvestment unlocked deals for local banks. Then, in 1994, with the advent of democracy, deal-making was further stimulated as large South African corporates were able to expand offshore and shed non-core assets. Black Economic Empowerment (BEE) legislation, introduced in the early 2000s, was a further deal stimulant, and continues to be so today. Our dynamic industry has adapted well to take advantage of these many opportunities.

South African private equity has also been shaped by international forces. While our industry emerged from the global financial crisis in better shape than most, the crisis undoubtedly had an impact both in a reduced appetite for this asset class and in an acceleration of financial regulation applicable to our industry. We saw many of the banking participants, traditionally committed private equity players, exit this asset class as a result.

While recent times have seen these players leave the industry, there have also been many new notable entrants. International investors increasingly see Africa as an attractive investment destination. They want to share in what Africa has to offer, and deals today often include foreign partners and consortiums, and extend into the rest of the continent. This new perspective on African growth has seen a number of international private equity firms set up operations in South Africa. Likewise, many local firms can now be considered true pan-African investors. In this publication, we touch on our industry's increasing reach into Africa -- a theme which is likely to develop over time.

Today, SAVCA's membership sits at eighty-five firms. Our industry, which was first developed by balance sheet investors at the large banks, now has participation from captives, independent third-party fund managers, venture capital investors, mezzanine finance houses, as well as fund–of-funds providers. Our member base spans a diversity of investment mandates, typical deal sizes and even geographies. Over the years, the industry has changed enormously; we have seen women entering the business, welcomed specialists from other disciplines, increased our use of technology and upskilled to meet ever-stricter regulatory requirements. BEE has also shaped the industry in several ways, including deal structuring, fostering black-owned firms and bringing in new talent.

An account of the history of the industry would not be complete without the story of SAVCA's origins. In compiling this document, we have spoken to previous chairs of the Association, board members and CEOs, and we have been struck by the sense of camaraderie that prevailed from the early days.

We hope you enjoy this reflection on the industry, its highlights and its achievements over the decades. We have attempted to capture as many voices in this publication as possible, speaking to forty-three people from thirty firms. Nevertheless, we emphasise that this publication merely touches on some of the key themes and significant players, and is far from being a comprehensive depiction of events, firms and people that helped shape and define the industry over thirty years.

It has been an enlightening and hugely enjoyable process for the project team involved. On behalf of SAVCA, I would like to thank my peers for sharing their experiences, insights and views of the future.

Johannesburg, February 2015

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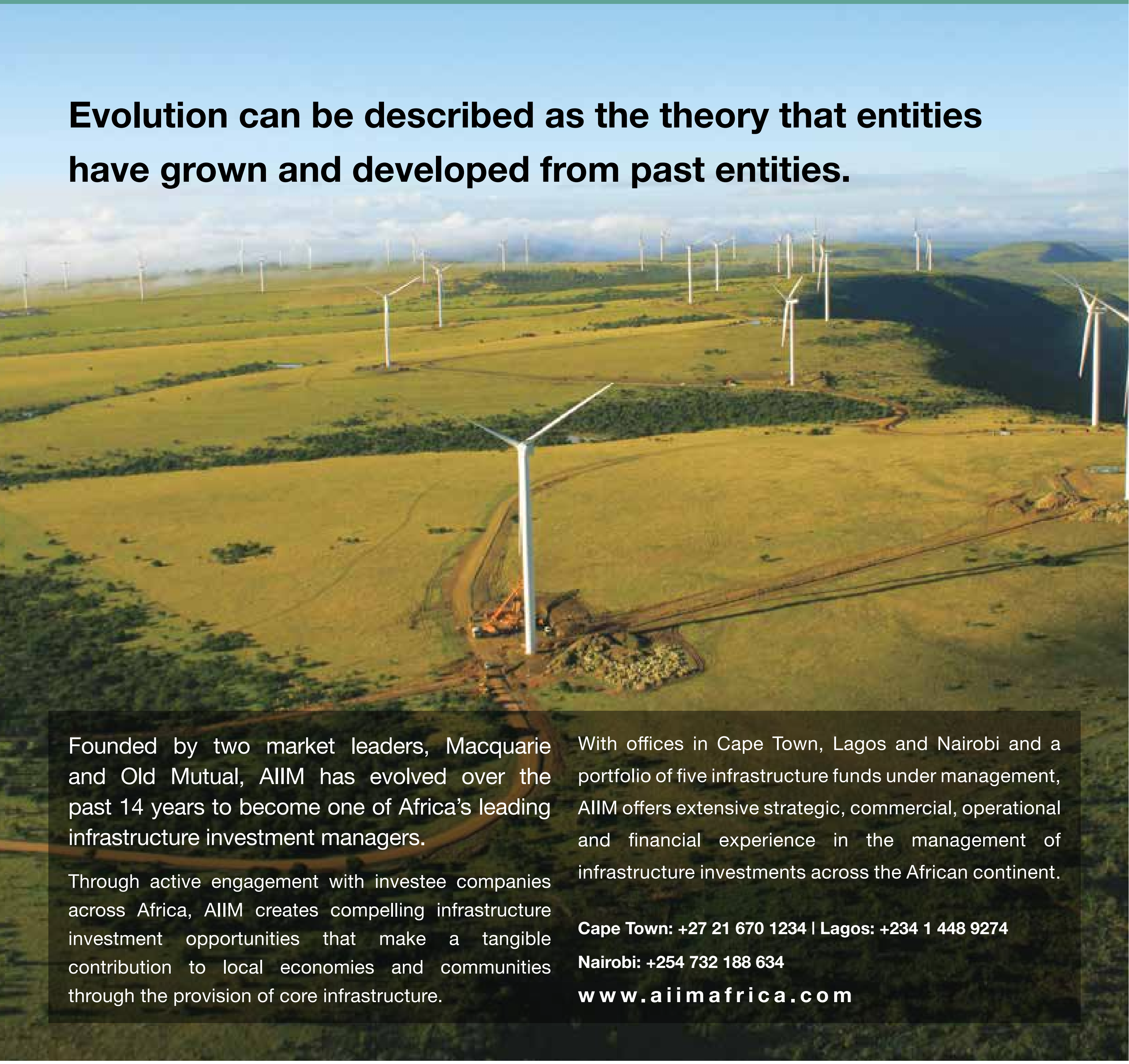

Evolution can be described as the theory that entities have grown and developed from past entities.

Founded by two market leaders, Macquarie and Old Mutual, AIIM has evolved over the past 14 years to become one of Africa's leading infrastructure investment managers.

Through active engagement with investee companies across Africa, AIIM creates compelling infrastructure investment opportunities that make a tangible contribution to local economies and communities through the provision of core infrastructure.

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Three decades: Tracking the emergence and establishment of South African private equity

With a challenging start in the mid-1980s due to economic sanctions against the country and an international disinvestment campaign, South African private equity has had a fascinating progression in the decades since then. The industry today funds businesses in almost all sectors of the economy, has clinched more than 2 500 deals in the thirteen years since the turn of the millennium and attracts sizeable long-term foreign investment commitments from Europe, the UK, North America, the Middle East and Asia.

Tracking the industry's development to this point provides unexpected insights into the workings and recent history of South Africa's banking and business system. It is also a reminder of the sheer scale of regulatory proliferation and overhaul that has taken place in the space of three decades – and lifts the lid on the personality profiles of private equity practitioners.

West coast roots

These personalities arguably are as colourful and resolute as the founders of contemporary private equity in the USA, which dates back to the early 1950s.

Antony Ball, non-executive chairman of Rockwood Private Equity and a previous CEO of Brait, describes an era when innovative facilitators operating on the US west coast would rustle up funding for investment, and then take a fee and profit share. "That model was then applied by the pioneers of the industry, such as KKR and Blackstone, and mainly to leveraged buyout deals."

The mid-1970s to early 1980s were phenomenal for the industry in the USA, with highly leveraged deals being struck at moderate earnings multiples. These early successes naturally stimulated interest in the private equity asset class.

Driven in the US by the dissolution of inefficiently run large conglomerates, as well as a thriving junk bond market, private equity crossed the Atlantic to hit Europe in the mid-1980s, by which time UK private equity was already well established, having started there in the late 1970s.

The industry appeared in emerging markets in the late 1980s. By the mid-1990s, it started to be officially known as "private equity" in South Africa, although the industry here can trace its roots back to the 1980s, when a number of private equity-type deals were made by banks, insurers and other captive investors.

Distressed sales and an eye for value

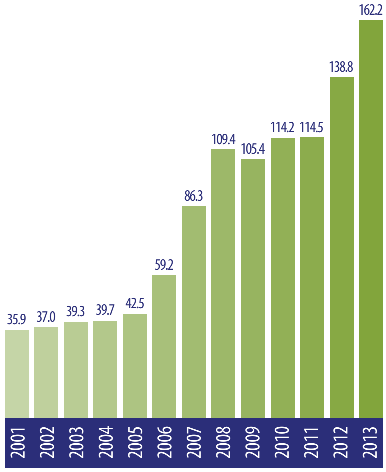
The disinvestment drive by US and UK corporations from South Africa reached dramatic scale from mid-1984 onwards, owing to heightening political pressure in the US, UK and Europe on political and business leaders to take a stand against apartheid, and to enact economic sanctions.

"South Africa's private equity industry effectively kicked off at this time, with impetus coming from P.W. Botha's 1985 Rubicon speech," says Neil Page, managing director of RMB Corvest. "Offshore companies were leaving the country and disinvesting their South African assets. Before then, large foreign businesses constantly had to defend their very small South African interests to shareholders back home. With the 1986 US promulgation of anti-apartheid legislation, they decided rather to get out."

With some exits from South Africa being done in haste, locally based dealmakers

A dozen years of steady growth

Funds under management by year end, in Rbn



Source: SAVCA-KPMG Private Equity Industry Survey, June 2014

Antony Ball

Tracing private equity BACK IN TIME

Colourful stories abound about the ancient roots of private equity. Centuries ago, it was customary for Phoenician merchants and European traders to pay a fifth of their profits to their ship captains in return for taking risky journeys to the New World and the Far East, setting the precedent for the carry structure used in private equity across the globe today. Arguably the very first private equity-type business to be set up in South Africa was that of the Dutch East India Company, established in the Cape of Good Hope in 1652 and funded by entrepreneurs in Holland.

Proudly representing private equity

SAVCA is proud to represent an industry exemplified by its dynamic and principled people, and whose work is directed at supporting economic growth, development and transformation.

SAVCA was founded in 1998 with the guiding purpose of playing a meaningful role in the Southern African venture capital and private equity industry. Over the years we've stayed true to this vision by engaging with regulators and legislators, providing relevant and insightful research on aspects of the industry, offering training on private equity and venture capital, and creating meaningful networking opportunities for industry players.

We're honoured to continue this work on behalf of the industry.

SAVCA
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found valuable buying opportunities. Amongst them were the forerunners of today's private equity firms.

"Although the underlying businesses were sound, the sales were in fact distressed, as sellers wanted urgent exits, usually before their December year ends, to avoid another round of explaining to shareholders. Low valuations, of two to four times EBITDA, were the norm," Page says.

Because the companies being sold were operationally solid, transactions of the time were really structuring opportunities, recounts Page. "We used optimal levels of gearing and also persuaded an incentivised management team to buy into the deal. At the time, private equity in South Africa was very much an in-house, on-balance-sheet affair."

André Roux, a stalwart of the South African private equity industry and founding partner of Ethos Private Equity, recalls his early experiences in corporate banking and dealmaking. By the early 1980s, he had qualified as a chartered accountant and was working for Barclays Merchant Bank in the UK. "It was here that I was first exposed to the private equity model of the time, and I brought those ideas back to the South African office. Our very first deal, concluded in 1984 and in partnership with Volkskas Merchant Bank, was the acquisition of Hudaco Industries from Blue Circle, in what at the time was the largest South African private equity leveraged buyout."

Roux says the success of the deal enabled his team at Barclays National Bank to motivate for further capital from the banking parent. "We did several more deals based on disinvestment from well-established local operations, all done on the back of the bank's balance sheet, and thereby building a solid track record for ourselves."

As part of the disinvestment drive from South Africa, Barclays in 1986 sold its remaining South African banking interests – including the division that housed André Roux and his team. In South Africa, Barclays was subsequently rebranded as "First National Bank" ("FNB", for short).

André Roux

> *What has characterised our evolution has been our ability to redefine the boundaries of our business and take advantage of the opportunities that inevitably arise out of environmental and structural change.*
>
> *André Roux, in reference to the evolution of Ethos Private Equity, on the firm's 25-year anniversary: July 2010*

Moving towards democracy

A further phase in the development of the industry was triggered when large South African companies began to globalise, offloading their non-core local businesses in a wave of corporate restructurings. In the 1990s, this trend of "de-conglomeration" saw many attractive businesses becoming available to local private equity players, the vast majority of whom were located within the major banks.

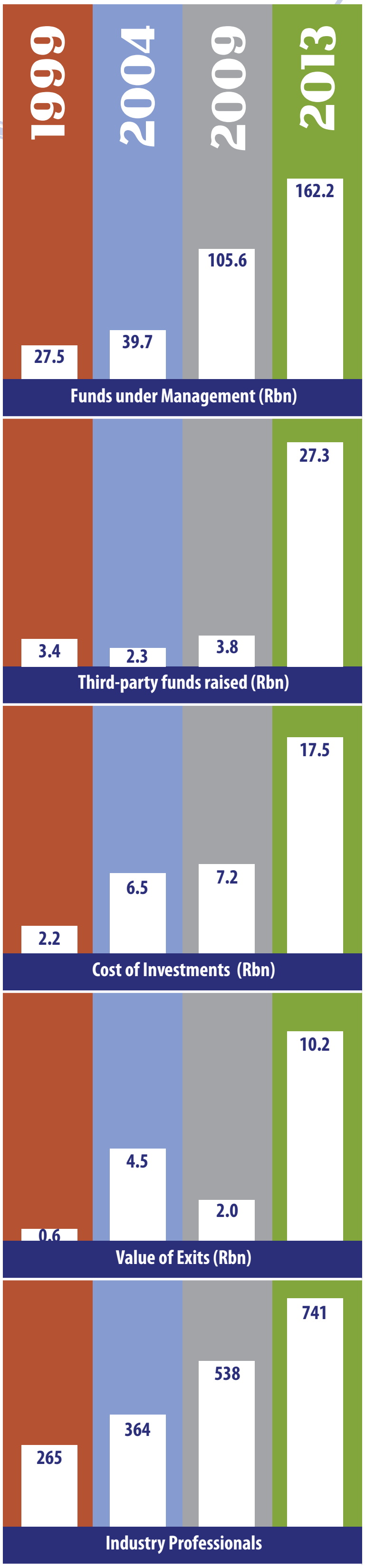
It was also an interesting time politically. Sanctions had been repealed in July 1991, after South Africa had taken steps to address the preconditions of the 1986 Comprehensive Anti-Apartheid Act enacted by the US Congress. With the build-up to the 1994 elections, there was notable corporate nervousness and investor uncertainty.

Fundamental shifts were taking place in the South African private equity model. "It was in the early 1990s that we began to see the start of third-party fund raising." says Page. "This was the beginning of a move from balance-sheet funding of deals by banks to the use of third-party funding."

Neil Page

Evolving towards maturity

Growth in the South African private equity industry, by numbers



Source: SAVCA-KPMG Industry Surveys, various years

Roux explains that development of the third-party model was spurred by long-term concerns regarding regulatory constraints being placed on bank capital and capital demands from traditional banking activities. For instance, FNB in 1992 established FirstCorp Capital Investors, which managed South Africa's first multi-investor, third-party private equity fund, comprising FNB, a pension fund and an insurance company as investors.

"This fund, which was the forerunner of what would become Ethos Private Equity, had great success, in part thanks to the pervasive concerns at that time about South Africa's transition to democracy. You could buy attractive businesses at that time of scepticism, and valuations were depressed."

Roux adds that, as "we were no longer investing exclusively off the bank's balance sheet, we needed to build structures in order to manage conflicts of interest."

Also active at the time were the key players in what would eventually develop into Brait Private Equity: Antony Ball and Thierry Dalais founded Capital Partners in 1991, harbouring great ambitions.

"We had our targets set on doing private equity outside of banking structures, using the US model of independent third-party funding, and we set about raising money," says Ball. "We found it to be quite a difficult process , however, as it seemed that the US approach, which was very entrepreneurial, did not sit well with the South African investor mind-set of the time."

The duo found favour with Fedsure, though, who came on board as a single sponsor with an initial allocation of R50m and who agreed to a fee and carry arrangement. The fund, which would eventually be branded "Brait I", closed late in 1991, and invested in around seven companies over fifteen months.

Venturing beyond South Africa

Emboldened by experience and pleasing track records, combined with the fact that international markets were opening up to South Africa following the move to democracy, the teams that eventually would become Ethos Private Equity and Brait simultaneously began working on subsequent funds – with a view to incorporating international investors.

Anthony Hewat, who had joined Capital Partners in 1994 and who had gone on to become a founder and director of Metier, explains that South Africa had, at that point, not seen international private equity structures. "We needed to bring international investors into our new fund in order to validate our move to the third-party funding structure. It was also an opportunity to make use of well-tested international benchmarks and twenty years of US and UK legal precedents."

International fundraising proved to be a gruelling experience, though, with new regulations and international tax implications needing to be factored in and with the teams having to spend months on end forging relationships with potential investors, all of whom had to be persuaded of what South African assets could bring to a large and globally diversified portfolio.

As Ball puts it, "The country was challenging to market at the time of democratic transition and, in 1994, I probably visited the US at least thirteen times to convince investors of our credibility."

Roux recounts those days as testing, yet rewarding. "This third fund, as well as the ability to access foreign funding, was a significant milestone for us. It required exceptionally hard work and two years to achieve, however, as offshore investors were ever so cautious and perhaps even sceptical about our political transition and our recovery from years of sanctions." He adds that an underestimation by foreign investors of South Africa's financial sophistication was yet another obstacle to overcome.

The funny part of it was that the two competing teams often would encounter one another in cramped anterooms, as they awaited their turn to pitch to possible funders.

Apart from having to sell the South African story and having to assure funders of the ability to deliver superior returns and healthy team dynamics, successful pitching also included demonstrating tight and professional fund structures to investors. Hewat recalls: "We focused intensely on the regulation, the relevant legal agreements, obligations, fee structures and conflicts of interest, and on how the drawdowns would work."

Both Ethos and Brait secured significant commitments from major US-based investors; Brait Fund II closed in 1995 and Ethos Fund III closed in 1996.

Richard Flett

A stock take in 1995 – a year after the establishment of democracy

A useful snapshot of the industry in 1995, a year after the establishment of democracy, is provided in a research paper prepared by Richard Flett for Anglo American and the Mitsubishi Corporation. Flett, who today is managing director of Horizon Equity, sums up some of his findings at the time: "At that point in the evolution of the industry, there were fifteen fund managers in South Africa; the overwhelming majority of whom were captives or semi-captives."

Included in the category of captive investors – that is, funds that rely on in-house funding rather than on raising independent, third-party capital – were the banks, including RMB, Investec, Standard Bank and Nedcor Investment Bank, who were all beginning to grow as notable private equity players.

Flett singles out three examples of independent or near-independent funds: Capital Partners, the precursor to Brait, was one; FirstCorp, the Ethos predecessor, was another. A third near-independent fund, although still in formation during 1995, was Msele Nedventures, an empowerment-focused fund that combined Nedbank funding with that of European development-finance institutions.

"With the exception of Capital Partners and FirstCorp, who put in place the traditional private equity incentive model of two-and-twenty, funds had typical banking remuneration structures," Flett explains.

In fact, much of the industry culture – and not only remuneration models – was driven by the banking industry; that included an emphasis on the use of debt and debt-like instruments in transaction funding.

"There was a great deal of risk aversion, and the use of debt instruments helped lessen risk," Flett says. "The principle of investing in a high-yielding debt instrument with an equity kicker goes way back in the South African corporate DNA – and is very different from elsewhere, where a clear division exists between debt and equity."

Flett offers the reminder that, in the mid-1990s, there was no definitive use of the term "private equity" in the South African banking industry to describe this investment activity; instead, the industry opted for "balance-sheet investing" and "investment banking".

The statistics gleaned by Flett for 1995 reveal that an investment of over R20m was considered a large deal, and that the emphasis was on management buyouts as opposed to growth capital, venture capital or – with one or two exceptions – SME investing.

For perspective, consider the fact that, by 2013, R30.2m was deemed the average deal size, with the top ten deals by size in that year each attracting total transaction funding in excess of R300m. And, by the same year, the value of buyouts as a proportion of total investments made reached just over 35% (data for 2013 taken from the SAVCA-KPMG Private Equity Industry Survey of June 2014).

Flett's research puts the industry in 1995 at an estimated R3bn in assets under management, compared with the R162bn for 2013. And, compared with the fifteen fund managers he counted in those early days, around eighty-five private equity fund managers are SAVCA members today (see "Capital camaraderie: The birth of an industry association" for more).

A highlighted history of
Ethos Private Equity

1984
As a division of First National Bank at that stage, the entity that would become Ethos completes its first buyout under the leadership of André Roux.

1992
Ethos becomes a semi-captive and raises its first third-party fund, consisting of allocations from companies, institutions and FNB. Its Fund II closed at R116m ($34m).

1996
Ethos raises an internationally funded private equity fund, Fund III, which closed at R750m ($175m).

1998
Ethos becomes independent. It raises R2.3bn ($350m) for Fund IV.

2006
Fund V is raised, at R5.6bn ($750m).

2012
Fund VI is raised, at R7bn ($800m).

2014
Stuart MacKenzie succeeds André Roux as Ethos' CEO.

Source: www.ethos.co.za

From the media archives:

Extract from the Firstrand Limited Stock Exchange News Service announcement on 24 June 1999

Firstrand Notice of the Formation of the Group

Under the new structure, Firstrand Bank Holdings (formerly "FNB Holdings") will be the holding company for the combined banking operation including Firstrand Bank Limited, FNB's African banking interests, RMB Investment Capital, Firstrand International and other banking interests. RMB Investment Capital is the private equity fund arm of the Group, comprising third-party fund Ethos and the equity funds RMB Corvest and RMB Ventures.

Renewed confidence

A few themes characterised private equity from the latter half of the 1990s and into the new millennium. Owing to international regulatory changes in banking, overseas banks started selling off their private equity divisions to independent managers.

Further, with the doors to international fundraising having been opened, the opportunity then existed for independent funds relying on third-party financing to target ever-larger funds – and ultimately bigger deals. It was also the years of post-election confidence and a prevailing sense of expectation that fresh economic policy would create investment opportunity.

In 1998, FirstRand was established through the merger of FNB with RMB and Momentum. In order to avoid potential conflicts of interest within the merged entity, the FNB private equity business – FirstCorp – was spun out and Ethos Private Equity was established as an independent entity, majority-owned by Ethos employees.

"Investors felt more comfortable with this ownership structure, as it circumvented any potential conflicts and ensured complete alignment between ourselves – as the private equity fund manager – and our investors. As a result, the business continued to grow progressively," Roux says.

That first year of independence saw Ethos close its Fund IV at $350m which, in dollar terms, was nearly double the size of its previous fund.

Also in 1998, Capital Partners merged with the investment banking interests of Capital Alliance Holdings, and the new firm was named "Brait". It closed Brait III at $409m.

Roux observed that, as funds became progressively bigger, the international share of funding expanded, too. "Our Fund IV was evenly split between local and international investors; by Fund VI we had a 70% international share. The experience of other South African fund managers has probably been similar."

He attributes this to mounting confidence amongst international investors in South African private equity fund managers' abilities. "It demonstrates, too, that the South African savings pool available for private equity historically had not kept pace with the expansion in the industry. Local investors are now demonstrating increased appetite and sophistication, however, and enjoy expanded scope to increase allocations in the future" (see *A move towards the mainstream* for more).

Towards the latter part of the 1990s, and going into the new millennium, there was a relatively broad adoption of third-party-managed fund vehicles, based on international best practice.

"South Africa was enjoying strong capital inflows and fund raising was quick," says Cora Fernandez, head of Sanlam Investments and a former CEO of Sanlam Private Equity. "Investors were now comfortable with how democracy had developed and we were seeing manufacturing-led growth. There was widespread expectation that several state-owned enterprises would come up for privatisation, and private equity firms and their investors were looking at opportunities flowing from changes in government strategy."

Technology as an opportunity

In the run-up to the turn of the millennium, the technology boom appeared as a global opportunity.

US private equity funds were already specialising in various niche sectors, and technology now offered further scope for specialisation.

Although South African funds were generalists – and largely remain so to this day – some themes started to develop in the area of technology.

Richard Flett, managing director of Horizon Equity, recalls the notable boom in the JSE IT sector in the late 1990s. "On the back of that there was considerable demand for tech funds to invest in private companies. As a result, a number of venture capital technology funds emerged" (see *Venture capital endeavours* for more).

This included Horizon Equity's second fund, which was established in 2001 with funding support from the IDC. Flett recalls counting over 15 tech funds established around that time, with close to R2bn in capital available for investing in South African technology and Internet ventures. Unfortunately, very few of these funds produced anywhere close to acceptable returns and most of the fund managers involved have long since left the arena.

The Vantage Technology Fund was another that was set up with anchor funding from the IDC, with additional capital from Transnet and Eskom. Colin Rezek, a co-founder of Vantage Capital, reminisces that "some great technology was being produced in South Africa at that time. Admittedly, some of the ventures into which we invested were write offs, and we learned that, no matter how good a technology is, tech companies also need to be staffed by good people with business management and finance skills. But we did experience some success unlike several other funds, some of which lost all of the money they invested."

A transforming industry

The first recorded private equity-led BEE deal was the 1993 Ethos investment into Kagiso Khulani Supervision Food Services. By the early 2000s, almost every deal being clinched in private equity had a BEE element to it – and the industry had established itself as a major role-player in bringing about empowerment.

In fact, the workings and approach of the private equity industry lent itself to being a tool for empowerment: the combination of private equity investment and bank loans "allows the implementation of an appropriately geared financial structure, allowing management of the investee company to acquire a significant stake in the company. This leveraged model also creates opportunities for the involvement of black management and other BEE parties in the ownership and management of the investee company," as explained in the SAVCA-KPMG Private Equity Industry Survey of June 2014.

Meanwhile, as the industry continued to embrace the independent model, the newer names in the business were firms founded by teams and individuals who had gained experience in existing firms and investment houses, and who were forging new ground.

One notable example is the formation of Metier in 2004, with the exodus of Thierry Dalais, Paul Botha and Anthony Hewat from Brait. The team focused on the provision of mid-market growth and replacement capital, and closed its first fund between 2006 and 2007.

Another is Capitalworks, which was formed at the end of 2006, when Chad Smart and Darshan Daya, both previously from Brait, established a private equity house focused on partnering with entrepreneurs and management teams in the mid-market

FUND SNAPSHOT

Medu Capital

Medu Capital was founded in 2003.

First fund closed in February 2003:

Investors/ LPs: South African Private Equity Trust III

Most significant investment:

Our investment in Vitalaire was a significant investment in the history of Medu Capital. That was our first investment. That investment was significant in enabling the company to demonstrate its investment philosophy.

Three biggest changes since those early years:

- The business is now wholly owned by the management team of Medu Capital.
- Raising capital commitments from international LPs for Medu Capital Fund III.
- Establishment of the DTI BEE Codes of Good Practice, with guidelines for Private Equity.

TRANSFORMING PRIVATE EQUITY

Noteworthy and early empowered private equity firms were the Tiso Group, Kagiso Trust Investments and Shanduka. All three groups eventually worked their private equity funds down, and went on to become investment holding companies.

Empowered firm Sphere Holdings was formed in 2003 and, by 2006, had raised R300m for its debut private equity fund. Sphere has since moved to become an investment holding company, in partnership with Ethos Private Equity.

Medu Capital, established in 2003, today retains its third-party funding model and is on its third fund.

FUND SNAPSHOT

Capitalworks

Capitalworks Private Equity was founded in 2007 by Chad Smart, Darshan Daya and Garth Willis.

First fund closed in 2009:

Investors/ LPs: insurance companies, pension funds and family offices

Mandate: Middle-market, growth investing in South Africa, across industry sectors

Most significant investment:

Rhodes Food Group – Recently listed successfully on the JSE.


Peter Schmid

From the media archives:

SAVCA comments on the impact of the global financial crisis

6 May 2009

What is certain, said Cora Fernandez, deputy CEO of Sanlam Private Equity and chairperson of SAVCA, is that experienced managers have demonstrated their ability to adapt in a changing and challenging market. "Globally, merger and acquisition activity has slowed and mega deals have evaporated. Investors remain cautious since earnings visibility is a major challenge and debt markets have improved marginally. There is no shortage of debt for good deals, but the amount of debt offered has come down along with gearing levels. We have, in essence, gone back to private equity basics."

Looking ahead over the next few years, J-P Fourie, executive officer of SAVCA, said that more equity-only deals were a strong possibility in South Africa and around the world. "But raising funds in a climate of depressed corporate earnings will be a challenge. We will also see the life-cycle of a private equity deal increase as companies take longer to convert investment funds into tangible business results."

Source: FA News

growth space. Capitalworks has gone on to raise three successful funds since its establishment (see *It's a people's industry after all*, for more).

Heady days – and then reality

Peter Schmid, head of Private Equity at Actis, and previously from Ethos Private Equity, describes South African private equity in the years leading up to the 2008 global financial crisis as golden days of robust activity. "At that time, we were taking public companies private. Bank funding was readily available and we could do control deals at multiples of six to nine times EBITDA."

Notable take-private deals included Foodcorp, Waco, Tiger Wheel and Tyre (all three led by Ethos) and Alexander Forbes (Actis, in partnership with Ethos and other international investors). Other substantial deals were Life Healthcare (Old Mutual, RMB and Brimstone) and Alstom (Actis, Old Mutual, Tiso and Kagiso).

With such opportunity being found in the local industry, Schmid and colleague John van Wyk joined the emerging-market private equity firm Actis in 2004. A spinout from the UK's overseas development arm CDC, which in turn was founded in 1948, Actis has a team the majority of whose members had worked at CDC and who brought years of experience investing in Africa, Asia and Latin America.

"John and I arrived at Actis, tasked with the responsibility of turning around the South African portfolio – inherited from the CDC – and building the profile of the firm. The CDC had taken a minority, growth-capital approach to its deals in the market; we were now working to shift the focus to control deals and buyouts, and to look beyond South Africa for transactions," Schmid says.

It was a time when local players were joining up with foreign consortiums to do very large transactions, many of them heavily leveraged by South African standards and, moreover, using high-yielding Eurobonds for the debt component. (see *A brief history of the use of debt in South African private equity* for more.) Other such high-profile South African-based transactions during this time included Primedia, Consol and Pep – as well as the acquisition of Edcon by the US-based private equity behemoth Bain Capital.

"It took almost a year for the full effect of the global financial crisis to hit emerging markets," Schmid says. "This gave us the leeway to implement preparations in most of our portfolio companies. We did not have any covenant breaches in our investments, but many deals of that time in fact collapsed, and exits across the spectrum were slowed down as a result."

Paul Boynton, CEO of Old Mutual Alternative Investments, says South African private equity managers got stuck into to their portfolio companies, ensuring that cash flow was tightly managed, and keeping management intent on delivering through that difficult patch. "We did not have the carnage seen in the private equity market in the US and Europe. The South African private equity environment was certainly tight, but we could trade through it."

Old Mutual's first fund of funds was launched in 2006, containing underlying investments that dated back to 2004. "This fund did well and was largely fully invested before the frothy peak of 2008. It is now fully cashed out, at four times money. In our Old Mutual Multi-Manager Fund II, launched in October 2007, however, we saw the impact of the global financial crisis across all our managers and, consequently, the impact that vintage risk could have on a private equity fund-of-fund portfolio. Although this particular fund has underperformed to date, there still is enough time left for recovery, Boynton says. (See *A future for fund of funds*.)

Muted M&A, moving towards recovery

Owing to dented confidence, mergers and acquisitions activity has been muted since the 2008 crisis. John Bellew, a partner at Webber Wentzel, describes the swing in activity observed in the immediate aftermath: "Following the crisis, buying simply stopped. It became difficult to come up with predictions of company earnings in the post-crisis world, added to which many sellers hadn't adjusted to the new reality, which resulted in an enormous pricing gap, especially in the big-deal space." He views the mid-market deal space as having been less affected.

The impact has not been entirely market driven, with recent legislative changes also influencing decision making in the deal-making space. (See *Regulatory evolution* for more.)

"The introduction of the new Companies Act has also been a deterrent to asset acquisitions, as it introduces further deal execution risk in a take-private process. As a result, we've seen hardly any delistings recently, with the Ethos-led take-private of Universal Industries being one of the exceptions," Bellew says.

Settling into renewed industry growth

Local private equity is now at a stable and maturing stage of its development, having recovered strongly since the financial crisis.

Bellew is witnessing a pick-up in activity levels, but points out that deal-flow levels are not yet commensurate with the volume of funds that have been raised. He adds that, in these tricky market conditions, he is seeing fund managers employing a strategy of quiet caution. "GPs appear to be focused on staying away from the listed market, and prefer proprietary deals to those secured via auction."

James Pullinger, investment professional at Ashburton Investments, describes what he sees as healthy signs of opportunity. "The cost of senior debt at present is very attractive for the industry. The sub-R1bn end of the deal spectrum, which tends to have a low profile, is very active, and we are starting to see signs of life in the larger end of the market, too."

Confirming the stability and appeal of the industry at this stage of its evolution, Itumeleng Kgaboesele, CEO of Sphere Holdings, comments that "competition for good assets in the mid-market space remains healthy and we are competing actively with local private equity firms and trade players". High asset prices, one of the consequences of an arguably frothy listed equity market, is a factor to consider and he warns that "if you acquire an asset, you must be confident that you can unlock further value".

The actors in this activity

Having been the driving force in the emerging stages of South African private equity, South African banks have re-evaluated their exposure to this asset class since 2008, in large part owing to the significantly stepped-up capital requirements imposed under the internationally adopted Basel standards.

The decision in 2010 by Barclays to halt its balance-sheet funded private equity

John Bellew

Brait through time

1991
Capital Partners is established and Brait I was raised.

1995
Brait II was raised, largely with proceeds from North American investors, including HarbourVest Partners, the Ford Foundation and the retirement fund of New York State. Domestic investors included Transnet and Eskom.

1998
Brait III closed at $409m. The management firm merged with the investment banking interest of Capital Alliance Holdings, was renamed "Brait" and listed.

2006
Brait IV was raised, at R6.1bn.

2011
Brait converts to a new business model, which in future would rely on capital raising from the public markets.

Source: Brait Annual Report, 2011

SIDEBAR

Changing perceptions and changing lives

The private equity industry has certainly had its highs and lows over the years and much work still lies ahead for this unique sector. "We have to admit that private equity is often a misunderstood investment class," says Thierry Dalais, chairman of Metier. "So, our on-going focus is to promote the vibrancy of our industry, its returns to investors and the role that it has played and should continue to play in improving the lives and prospects of people that are touched by this unique asset class."

Thierry Dalais

FUND SNAPSHOT

Nedbank Capital Private Equity

Nedbank Capital Private Equity was founded in 2003, previously BoE & NIB from 1996.

First fund:
Mandate: General mid-market

Most significant investment:
Aard Mining Equipment:
- Transformational impact of management shareholding incentivisation.
- Partnership approach with introduction of strategic guidance and governance.

Biggest changes since those early years:
- For the firm: It is not just about finding good investment assets; relationships and chemistry with management are vital.
- For the industry: The ever-greater importance of understanding the market and of doing research to enable genuine value add and superior investment performance; it is less about the gearing.

activities due to the implementation of new regulatory standards, had immediate consequences for its majority-owned South African banking business, ABSA: in early 2014, the Barclays Africa Group announced the sale of its interest in ABSA Capital Private Equity Fund I to a consortium that included HarbourVest and Coller Capital. At the same time, the ABSA Capital Private Equity team spun out to create a new independent fund manager, Rockwood Private Equity, to manage these assets.

Standard Bank's exit from private equity was a more gradual one; following its decision after the crisis not to do any new investments, it started a piecemeal programme of selling the assets in its private equity book.

Nedbank Capital adapted its approach to one of private equity, with an initial reduction in its book and a subsequent sustained focus on finding and managing deals that would deliver returns to justify the onerous banking capital requirements (see *Still banking on private equity: Q&A with Clive Howell, Head: Nedbank Capital Private Equity*).

Investec and RMB are notable exceptions amongst South African banks in having maintained a hefty private equity exposure: both banks have remained active deal-makers and both manage balance-sheet funded portfolios at the large end of the size spectrum in this market.

Alongside the shifting role for banks in South African private equity, there has also been a reassessment of private equity structures by some independent managers. Brait, which had been a vital and substantial player in the establishment and blossoming of the industry, is a notable example: In 2011 it announced that it would move away from managing third-party funds and would transform into an investment holding company. (See also *Aiming for excellence through exits*).

Buffeted by tough local and international fundraising conditions, others have followed suit. Importantly, however, local players such as Capitalworks, Ethos and Medu have enjoyed fundraising success.

Meanwhile, attracted by deal-flow opportunity in South Africa and across Africa, international private equity funds have, since before the global financial crisis, set up a presence in South Africa. Models have varied, ranging from firms managing African deals from a London head office to firms hiring local teams and setting up satellite offices in various African jurisdictions. Examples of international firms bolstering the South African private equity industry include Abraaj, which acquired the pan-African-focused Aureos in 2012, the emerging markets private equity firm Actis, Carlyle and Development Partners International ("DPI", for short).

Steady structures that thrive on change

South Africa remains an appealing market for private equity activity, with a number of compelling enablers: Standards and execution capabilities are world-class and access to debt and ease of exit both help to enhance returns. In addition, a number of South African private equity firms are well-positioned to take advantage of growth opportunities across sub-Saharan Africa by buying assets in other countries and by supporting the operational growth of their South African-based portfolio companies north of the border.

These are all facets of a sustainable industry that will continue to evolve, to create vibrant stories and to generate attractive returns.

Although South African private equity has progressed into an industry quite different in shape and tone from its early format, it had the makings of today's scale and accomplishments as far back as the early 1980s. Its practitioners had entrepreneurial drive, an instinct for recognising a good deal, an ability to focus on long-term outcomes – and a remarkable adaptability and resilience.

In fact, one of the few constants in the history of South African private equity over the past three decades has been its ability to adapt to change. Politics, legislation, regulation, access to international capital, economic cycles, technology and investor appetites have all shifted dramatically and at an almost punishing pace. The industry has adjusted at each turn and its professionals have remained focused. This malleability of spirit is an ideal foundation for the next three decades of success.

From the media archives:

South African private equity returns at 18.5%

18 January 2015

Rory Ord, Head of RisCura Fundamentals, comments on South African private equity's continued allure for institutional investors: "The private equity industry remains an attractive investment choice for patient investors with a long-term horizon. The returns offered compare favourably to the listed markets and offer important diversification benefits in the asset allocation decision. Furthermore, the growth in the industry is extremely encouraging, given the economic advantages offered by private equity funding and the hands-on management style it supports."

Source: Ventures-Africa.com

moving beyond private equity

$$\text{DevEq} = \text{PAT} * x + i^2$$ ™

At the heart of Phatisa is development equity; a balanced blend of private equity and development finance – striving to build sustainable assets on the ground, maximising returns for investors and enhancing our *impact* on the communities in which we operate.

{ www.phatisa.com }

PHATISA

Phatisa is a private equity fund manager that invests throughout sub-Saharan Africa. We are well represented throughout the continent, operating from offices in Mauritius, South Africa, Zambia, Kenya and Ghana, as well as maintaining a European presence in London. We currently have two sector-specific funds under management: the African Agriculture Fund (AAF) and the Pan African Housing Fund (PAHF), totalling more than US$ 285 million.

Phatisa is a member of the East Africa Venture Capital Association (EAVCA); Emerging Markets Private Equity Association (EMPEA); Global Impact Investing Network (GIIN); and South African Venture Capital & Private Equity Association (SAVCA).

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PHATISA IRR CALCULATOR APP

Capital camaraderie: The birth of an industry association

2000 – 2005

SAVCA Members' Directory through the years

The Southern African Venture Capital and Private Equity Association (SAVCA) was established in 1998, designed to service the industry and support its growth. While much has changed in the market and in the organisation since that time, the spirit of camaraderie and cooperation has been a constant theme.

Jo Schwenke in 2000

A name that is always mentioned in conversations about the early days of South African private equity is that of Jo Schwenke. Former head of Business Partners, he was also founding chairman of SAVCA.

Schwenke looks back on the early days of South African private equity with his hallmark enthusiasm. "There was very little media coverage of the industry in those days, and equally little understanding of what the industry was all about. Private equity was not seen as a separate or alternative asset class and it operated as a very tightly knit, close industry – as private as its name suggests. And there certainly was no industry body at that time."

The first attempt to establish some form of industry collective goes back to around 1987. Schwenke recalls the efforts of Graham Rosenthal, a chartered accountant with Arthur Andersen, to start a venture capital club as seen in the US. "We would meet frequently, at the Sunnyside Park Hotel in Parktown, Johannesburg, and entrepreneurs would pitch their business ideas to potential investors. All the reputable and wealthy investors of that time would attend, including Investec's Stephen Koseff. This association lasted for a few years and then fizzled out around 1990."

Several years later, the next move to create an industry body was more formal and concerted – and had the benefit of Schwenke's determination and vision. The industry was at the stage where it required an authority to represent its participants, speak with one voice to various stakeholders – particularly legislators – and facilitate efforts to improve all aspects of the industry.

A new era for South African private equity

Schwenke says that by 1998 it had become the opportune time to revive efforts to create an industry body. "By this time Remgro had founded VenFin, Ethos Private Equity had been established, the IDC was in the game, as was Business Partners, and government was exceptionally interested in supporting entrepreneurial businesses. In addition, there were a few small players who were raising money from the public – and not always ethically so."

A key outcome of establishing this industry body was that firms with SAVCA membership had something of a seal of approval to participate in the industry. They had serious and real money to invest, and had been vetted by their peers.

"Interest in joining up was overwhelming, from the very beginning," says Schwenke. "Everyone we identified as potential members in fact signed up – and we even turned away some applicants that were not up to scratch. So, SAVCA was born very quickly, worked very well, and hosted exciting speakers and events."

The founding SAVCA charter was based on the European equivalent. "I was close to the European Private Equity and Venture Capital Association at the time and we asked permission to use their charter as a template," says Schwenke. "We modified it to local conditions, approved it – and it was in play very quickly. We got off to a good start."

Small beginnings and a big vision

SAVCA functioned using very few resources in those early years, with members pitching in wherever they could. "We would run the organisation from my office with my staff assisting, and would use Remgro's Court House in Sandhurst, Johannesburg (with Johann Rupert's blessing), for our functions and AGMs. The body was run on a shoestring budget in order to keep subscription fees down, so there would be no excuses not to join. Members would absorb expenses and share their resources and premises with the association."

Shortly after the founding of SAVCA, the organisation published its first annual members' directory, listing member-firms' details and investment requirements. The first publication, in September 1999, carries Schwenke's foreword in his capacity as interim chairman and in which he states that "a healthy Venture Capital and Private Equity industry is good news for entrepreneurs and consequently for the economy".

Here Schwenke also sets out the objectives of the industry body:

> SAVCA intends playing a meaningful role in the Venture Capital and Private Equity Industry by:
>
> - promoting self-regulation
> - lobbying on behalf of the industry
> - disseminating information and publicity
> - arranging training for the staff of its members
> - researching the industry in South Africa

In line with these founding principles, SAVCA immediately began its work relating to regulation and lobbying, research, marketing and training.

Finding a regulatory voice

Craig Dreyer, CFO of Ethos Private Equity and an active participant in SAVCA's activities from the founding days, explains that "a key motivation behind establishing the member association body was to have a voice with respect to the drafting of any regulation and legislation which potentially may affect the private equity industry". At this time in the industry's evolution, he says, the private equity asset class was completely unknown to the key policymakers and legislators at the Financial Services Board (FSB), the South African Revenue Services (SARS) and National Treasury. "Our thinking was that we did not want to be finding out after the fact about financial services legislation that made no sense for the private equity industry. Instead, we felt strongly that we would rather be a key part of the development of such legislation."

SAVCA now has healthy and highly effective relationships with the major policy and legal role-players. "Our relationships today contrast markedly with those of a few decades ago when they were somewhat icy and untrusting," says Dreyer, who heads up the SAVCA Regulatory Sub-Committee. "We are now able to deal openly and frankly with difficult issues".

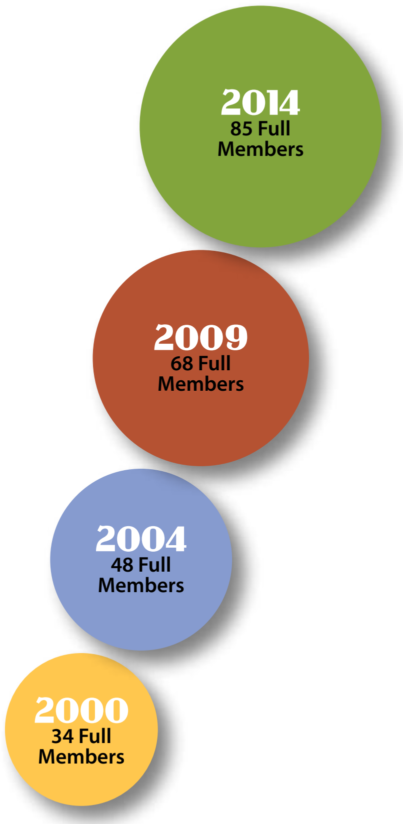
Researching the industry

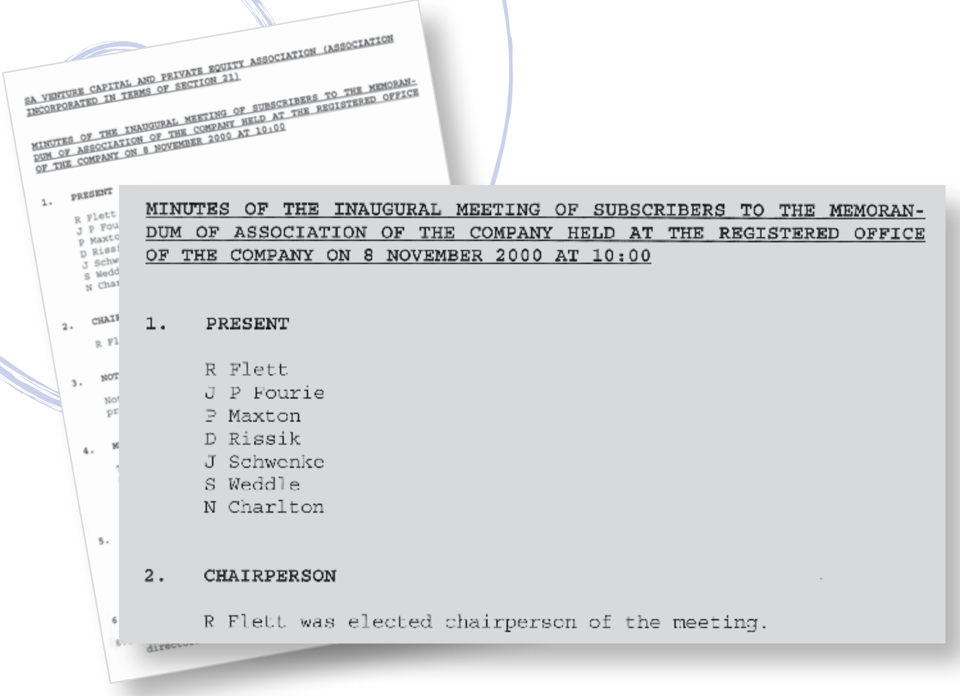
Today, as in the early days, this lobbying work is underpinned by research. SAVCA's research work began with a partnership with KPMG, for the production of an annual survey of the private equity and

Jo Schwenke

Then & Now

SAVCA membership trends over time





SA VENTURE CAPITAL AND PRIVATE EQUITY ASSOCIATION (ASSOCIATION INCORPORATED IN TERMS OF SECTION 21)

MINUTES OF THE INAUGURAL MEETING OF SUBSCRIBERS TO THE MEMORANDUM OF ASSOCIATION OF THE COMPANY HELD AT THE REGISTERED OFFICE OF THE COMPANY ON 8 NOVEMBER 2000 AT 10:00

1. PRESENT

R Flett
J P Fourie
P Maxton
D Rissik
J Schwenke
S Weddle
N Charlton

2. CHAIRPERSON

R Flett was elected chairperson of the meeting.

First page of the minutes of the inaugural SAVCA meeting held on 8 November 2000.

FUND SNAPSHOT

Horizon Equity

Horizon Equity Partners was founded in 1996 by Richard Flett and Steven Lipchin.

First fund closed in 1997:
Investors/ LPs: Anglo American, Mitsubishi Corporation
Mandate: Generalist Growth Capital for SMEs

Most significant investment:
Not one, but several: ATM Solutions, Peresys, Lincoln Lubrication. All involved investments in companies that were loss making or marginally profitable at investment, grew their business at least threefold during our ownership, and were ultimately exited through high value sales to strategic acquirers.

Three biggest changes since those early years:

- The widespread adoption of third-party managed fund vehicles based on international best practice, rather than the hodge podge of home grown vehicles found in the mid-nineties.
- The rapid increase in fund sizes experienced from 2000 to 2008 which, together with increased availability of leverage, led to massive inflation of deal sizes before collapsing in the wake of the global financial crisis.
- The tsunami of regulation that has hit the industry since the turn of the century, most of which was not originally intended to regulate private equity.

venture capital industry. The first survey, published in 2000 and contained in the 2001 SAVCA members' directory, reflects an industry which in 1999 had R27.5bn in assets under management and 265 investment professionals.

Schwenke served two terms as SAVCA chairman and was followed in 2002 by Malcolm Segal, previously a managing partner at Grant Thornton and who by this stage was managing a listed private equity fund. Schwenke is full of praise for Segal, saying "Malcolm added another level of professionalism as the second chairman of the association. He put the industry on the map, created visibility for the asset class, and raised our profile in the financial community and with the regulators."

During Segal's tenure, the position of full-time CEO was created. "SAVCA had a strong committee at that time and we were demonstrably adding value to our members," says Segal. "We started off with part-time CEO positions, being held by Para Naidoo and Troy Dyer. The annual SAVCA-KPMG survey was held in high regard, and the Financial Mail published an annual yearbook on the industry. Our members could see good things coming out of SAVCA and we needed to take this further."

A full-time CEO position required additional funding, and Segal said proposals were put forward to advocate this position. "Large industry players such as Ethos and Brait were big supporters of having a full-time executive, and we were able to raise membership fees to the level required to afford our first head."

A maturing industry and a sustainable association

J-P Fourie, who had been a Johannesburg Stock Exchange observer on the SAVCA board from early on in SAVCA's formation, was appointed as SAVCA's CEO in 2006. Fourie describes SAVCA at that time as being "poised for growth and acceptance, but not yet sustainable". Asked about the major challenges facing the organisation at the time, Fourie lists the drive to increase membership, gather and interpret industry data and, from a regulatory perspective, addressing the inconsistent tax treatment across different fund types of realisation gains.

J-P Fourie

Fourie notes that, during his six-year tenure, he saw an industry maturing, with larger amounts of capital raised and an increasing number of deals done. "Private equity was beginning to receive due recognition, especially in relation to positive regulatory changes and the regulatory acceptance of the asset class. And in this time I witnessed SAVCA becoming an accepted, respected and sustainable organisation, serving the industry and representing the voice of the industry."

At the board level, Mutle Mogase, who was co-founder and executive chairman of the Vantage Capital Group, followed Malcolm Segal as SAVCA chairman in 2006. In 2008, as the global financial crisis hit, Cora Fernandez, then deputy CEO of Sanlam Private Equity and already a seasoned SAVCA director, succeeded Mogase.

Cora Fernandez

Fernandez lists as one of the highlights during her time with SAVCA the ability of the organisation and the industry to overcome what had seemed very difficult relationships with government departments and regulators. She oversaw the publication of the 2009 SAVCA-DBSA Economic Impact Study, a ground-breaking report which brought to light the positive social, economic and developmental impact of private equity in South Africa.

"The results of this research went a long way towards dispelling what at times were negative perceptions of this asset class and opened up the way for more pleasant regulatory negotiations."

Emile du Toit

Emile du Toit, who had joined the SAVCA board in 2009, took up the SAVCA chairmanship in 2011. Dave Stadler, CEO of Paean Private Equity, was appointed chairman in November 2014.

Looking back at the evolution of the South African private equity industry, Schwenke reflects on SAVCA's humble beginnings. "As a founding committee our desire was to serve – and not be self-serving. And as an industry body, every single player was represented. There was great camaraderie; we were like-minded, had close relationships and were never competitive."

Then & Now

SAVCA introduces a new logo in 2005

SAVCA

SOUTHERN AFRICAN VENTURE CAPITAL AND PRIVATE EQUITY ASSOCIATION

From the SAVCA archives:

Extract from an interview with Emile du Toit, who served six years on the SAVCA board.

Du Toit has sat on both sides of the table, first as an LP at the DBSA, where he was a Divisional Executive for Private Equity and Investment Banking, and then as a GP in his role as Head of Infrastructure Investments at Harith General Partners.

Q: ***Emile, what were the most significant changes that you saw in the private equity industry during your tenure on the SAVCA board?***

A: The major change both in South Africa and globally has been the increased regulation on the industry following the global financial crisis. This regulatory burden has driven up the cost of compliance and makes it much less efficient to be a small fund manager and has given the larger players an advantage. This has meant that SAVCA has needed to take on a much stronger role than before in engaging with regulators, policymakers and legislators, as representative for its entire membership base.

During my tenure, it has been pleasing to see the changes to Regulation 28 by the FSB, which allows pension funds to increase their allocation to private equity from 2.5% to 10%. Take up by pension funds has been limited to date. As an industry body SAVCA still has substantial work to do in increasing the awareness amongst asset consultants and pension fund trustees of the benefits of private equity.

Timeline of private equity in South Africa

1981
The Small Business Development Corporation (SBDC) is established.

1984
As a division of First National Bank, the entity that eventually would become **Ethos, completes its first buyout.**

1985
P.W. Botha's Rubicon speech strengthens the drive to impose economic sanctions on South Africa, resulting in a massive exodus of foreign capital.

1986
The US enacts the Comprehensive Anti-Apartheid Act putting further pressure on US companies still operating in South Africa. This leads to buying opportunities for the large local banks, which start to develop in-house skills to manage an early form of private equity investment.

1989
RMB Corvest is founded.

1990s
Development finance institutions (DFIs) pioneer private equity investment on the continent. Those organisations investing in Africa at this time include the African Development Bank, the UK's CDC Group, Germany's DEG, the European Investment Bank, the Netherlands' FMO, the International Finance Corporation, France's Proparco and Sweden's Swedfund.

1991
Capital Partners is established; the entity later becomes Brait.

1996
BoE NatWest Equity Partners is established – the private equity division of BoE NatWest.

Sanlam Private Equity is formed.

1997
Horizon Equity is established through the raising of its first fund, sponsored by Anglo American and Mitsubishi.

2004
Old Mutual Private Equity is formed.

Actis is spun out of the CDC Group.

Metier is founded.

2006
Capitalworks is founded.

2007
The IDC brings its venture capital technology investments onto its balance sheet.

Ke Nako Private Equity Fund I, the first independent private equity fund of fund in South Africa, is set up.

Development Partners International is established, basing itself in London.

2003

Black Economic Empowerment (BEE) is enacted into law in 2003.
This important piece of legislation unlocks many private equity deal opportunities. Also, black-owned private equity fund managers emerge.

Medu Capital is founded;
it closes its first fund in February of this year.

Sphere Holdings is established.

Nedbank Capital Private Equity is formed,
absorbing amongst other entities the BoE NatWest private equity business.

2002

Shanduka (initially called Millennium Consolidated Investments) raises its first – and what would be its only – private equity fund.

2001

The IDC seeds a number of venture capital technology funds.

Vantage Capital is launched.

2000

African Infrastructure Investment Managers (AIIM) is formed.

1998

Sanlam Private Equity establishes South Africa's first private equity fund of funds.

The Small Business Development Corporation becomes **Business Partners.**

SAVCA is formed
with the goal of playing a meaningful role in the venture capital and private equity industry.

2014

Barclays Africa exits private equity with the sale of its 73.3% interest in Absa Capital Private Equity Fund I to a consortium including HabourVest and Coller Capital. Absa Capital Private Equity is spun off to become an independent fund manager, **Rockwood Private Equity.**

2013

Ashburton Investments is established under the FirstRand banner;
its activities include the creation of a private equity fund of fund.

2012

Abraaj Capital announces the acquisition of Aureos Capital.

The GEPF announces approval for its revised mandate,
which allows it to allocate 5% of its portfolio to unlisted investments.

2011

Changes to Regulation 28
allow South African pension funds to invest up to 10% of their portfolios in private equity, up from 2.5% previously.

Carlyle announces the formation of a sub-Saharan Africa fund
to be run from Johannesburg and Lagos.

2010 & beyond

Global private equity firms enter Africa,
with initial investments by iconic brands such as Blackstone, Apollo, KKR and Carlyle auguring well for further allocations and investments by funds with international horizons.

2010

Knife Capital is established,
with the objective of continuing the active management of Here Be Dragons' South African portfolio of investments and building the high-growth investment industry in South Africa.

2008

The global financial crisis hits private equity,
knocking investor appetite and triggering renewed caution amongst regulators globally.

Remgro establishes Invenfin,
to specialise in early-stage venture capital funding.

Aiming for excellence through exits

The first SAVCA-KPMG Private Equity industry survey, conducted in 2000, puts the value of exits in 1999 at R0.6bn – impressive for an industry that was still finding its feet and which represented a mere R27.5bn in assets under management. Commensurate with increased activity, a growing number of active funds and heightened awareness of opportunities in the market, the industry in 2013 reported exit transactions totalling R10.2bn in value. By this time assets under management had reached R162.2bn.

Various exit routes are popular in South African private equity, ranging from sales to trade buyers, disposals made to the incumbent management teams, buy-backs by the company, stock-market listings and the sale from one private equity fund to another.

The prominence of each exit route varies over time, depending on market conditions. Data taken from the SAVCA-KPMG Private Equity Industry survey show, for instance, that trade sales, exits through listings and disposals by selling to another financial institution have variously dominated the numbers over the years (refer to graph).

On the immediate prospects for exits in South African private equity, Graham Stokoe, executive director and Africa Private Equity Leader at EY, expects an uptick in exit activity.

"Funds established in the 2006-08 period are nearing the end of their life span. Listed markets are currently at high valuation levels, and private equity players looking to exit via a listing will want to move now, ahead of any possible market correction. And there are indeed buyers around at the moment. The international private equity groups are looking, and local and international corporates have cash available."

And, yet, Stokoe expects the average investment holding period to increase slightly from the current estimate of around five and a half years. Fund managers whose assets may have been ravaged by the global financial crisis may hold off on an exit as long as possible, to ensure adequate recovery in enterprise value.

He adds that lengthier holding periods are also driven in some instances by funds incorporating a more long-term investment approach. Stokoe cites the example of private equity firm One Thousand and One Voices, which invests on behalf of wealthy families and has a fund life longer than the typical ten-year fund.

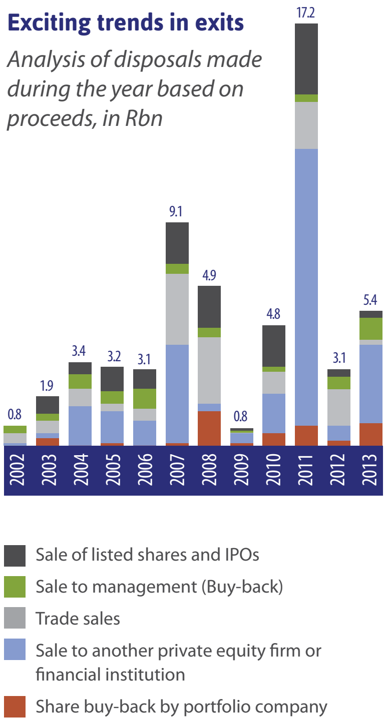
Development finance institutions (DFIs), sovereign wealth funds and family offices investing directly into portfolio assets – rather than routing through a private equity fund – are more flexible with regard to the holding period of a direct investment, and if portfolio businesses are generating healthy cash flows, DFIs might prefer to extend the life of the investment or may have a longer-than-typical lifespan from the get go.

In other cases traditional private equity funds have opted to shed the pure third-party fundraising model – which entails a ten-year commitment from independent investors – to transform into investment companies that rely on more permanent sources of capital. "My view is that this particular trend is being driven by the pressures of gruelling fundraising rounds and onerous regulatory requirements."

Brait is the most prominent such example in the history of the local

Exciting trends in exits

Analysis of disposals made during the year based on proceeds, in Rbn



Source: SAVCA-KPMG Private Equity Industry Survey, 2014

Graham Stokoe

industry. It moved in 2011 to convert from using a traditional private equity funding model linked to the churning of assets over the period of the fund, to become an investment holding company with permanent sources of capital. By July 2011, in the space of four months, it had raised R6.4bn through a public rights offer.

Another case is Sphere Holdings, which launched Sphere Fund I in October 2005. CEO Itumeleng Kgaboesele explains that Sphere initially followed a dual funding approach, using a combination of third-party funds and balance sheet funding. "We are now focused on building our balance sheet investing business and will not be launching a follow-on private equity fund. As an investment holding company, we have more flexibility regarding when to invest and when to exit. We are therefore able to optimise our exits – and can opt not to exit at all if the investee company is a top performer."

Despite moving away from a private equity model, Kgaboesele says the company still uses the discipline and focus of a private equity manager in the way it manages its portfolio of investments. "Good governance is still critical and we still have to report back to our investors."

Itumeleng Kgaboesele

From the media archives:

Brait in major overhaul, CEO quits.

2 March 2011

Johannesburg – Private equity group Brait [JSE:BAT] announced a major business overhaul on Wednesday and said its chief executive will be stepping down.

Brait said in a statement it will become an investment firm raising funds in the public equity capital markets from time to time and focus on growth, a departure from the company managing third party funds raised from investors to fund private equity investments.

"The board of Brait believes that ... there is an opportunity to maintain the existing strengths of the private equity model while, for the first time, tapping into the strategic benefits of raising funds from the public equity markets through a listed vehicle," Brait said.

The company said it will raise an initial R6bn through a rights issue, the majority of this will fund the acquisition of significant stakes in unlisted retailer Pepkor and foods firm Premier Foods.

Brait said CEO Antony Ball will step down and will be replaced by Brait Private Equity CEO John Gnodde.

Source: Reuters

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Regulatory Evolution

The proliferation of legislative, regulatory and reporting obligations for private equity remains a common topic in conversation about industry developments. Industry experts argue that these requirements will play a notable role in shaping private equity, including determining which fund managers are likely to survive in coming years. Meanwhile, the constant rolling out of new draft legislation globally keeps industry bodies, including SAVCA, in ongoing dialogue with the regulatory authorities.

Private equity in South Africa and elsewhere is not considered a heavily regulated industry; nevertheless, virtually all aspects of the private equity fund-management process are governed or influenced by law, regulation or guidelines. Today, fund managers raising capital in the domestic market as well as in most international jurisdictions are required to abide by strict qualifying and reporting requirements. The legal context also influences how private equity funds are structured, it shapes the process by which portfolio assets are acquired and how deals are put together, and also how these assets are managed and eventually exited.

A drive, globally, to step up financial regulation

Hemal Naran, head of Investment and Actuarial at the Government Employee Pension Fund (GEPF), notes that regulatory compliance is becoming a significant issue for the industry. "It has been one challenging year after another with rafts of regulation from various global jurisdictions coming on stream at a relentless pace. Recent international developments include the Alternative Investment Fund Managers Directive (AIFMD), Solvency II and the Volcker Rule. These can have a negative impact on private equity to the extent that the cost of compliance eventually could outweigh the efforts of investing."

Craig Dreyer

Craig Dreyer, CFO of Ethos Private Equity, and a key player in SAVCA's regulatory lobbying from its inception, acknowledges the importance of regulatory protection and guidelines for the financial sector, including private equity. Dreyer emphases, though, that such legal obligations and requirements must factor in the unique nature of private equity. Failure to do so could undermine the sustainability of the private equity industry. "Local regulatory hurdles are very steep. And while we can manage this and focus on compliance, the legislation must be appropriate to our business".

Open communication with the authorities

Dreyer recalls a number of interactions over the past fifteen years or more between SAVCA and South African policymakers and legislators, on matters ranging from tax policy to licensing, that eventually resulted in a more sensible approach from a private equity perspective.

For instance, SAVCA's extensive engagement in recent years with National Treasury on amendments to the Income Tax Act relating to interest tax deductibility – Section 23N – have had positive outcomes. Predating these changes, SAVCA had many discussions with National Treasury following its proposed moratorium, in June 2011, on the use of Section 45 of the Income Tax Act (a dispensation which allowed tax relief for intra-group transactions), and its subsequent replacement with Section 23K.

Another notable area of progress with respect to tax legislation is one that has had a considerable effect on private equity fund structuring. "Until

Private Equity benefits from a tax safe haven

In view of the uncertainty as to the intention of a shareholder, the legislature introduced a safe harbour rule under section 9C of the Income Tax Act for both listed and unlisted shares in South African resident companies in terms of which profits from the sale of shares that have been held for at least three years will be regarded as being capital in nature and thus only be subject to capital gains tax and not income tax. This does not mean that the proceeds on the disposal of shares held for less than three years will automatically be of a revenue nature – depending on the circumstances, such proceeds may still be regarded as capital in nature.

Source: L. Modise, W. Horak and C. Van Zuylen, "Getting the Deal Through: Private Equity in 29 Jurisdictions Worldwide, 2014", Page 281 very recently, when raising capital from non-residents, if we put that non-resident investor into a South African partnership structure, that investor would have been deemed a South African resident, and would have been liable for capital gains tax in South Africa," explains Dreyer.

To eliminate the anomalous tax treatment of foreign capital, the result was the setting up of offshore partnership structures to accommodate non-resident investors. However, thanks to concerted lobbying by the industry, tax legislation was amended to exempt foreigners investing into private equity fund structures from South African capital gains tax. "While this legislation is now in place, it will take a few years to come through our system, as fund structures have lifespans of twelve years or more," Dreyer says. Ultimately it will mean that new fund structures could be domiciled in South Africa, rather than being based in offshore jurisdictions.

A further historic achievement for private equity in the taxation arena was the inclusion of private equity into the so-called safe-haven provision of the Income Tax Act, which meant that gains upon disposal would be treated as capital in nature rather than income.

"The problem was that there was no guidance on the tax implications of holding a private or unlisted investment for a period of more than five years, and private equity investors could not rely on the safe-haven position of Section 9B of the Income Tax Act," says Dreyer.

"SAVCA mounted an enormous representation on behalf of the industry and successfully got Section 9C introduced so that private companies would fall within the safe-harbour rules. Additionally, the qualifying safe-haven holding period was reduced from five years to three."

A further significant area in which SAVCA lobbied for relief for the local private equity industry was in the licensing requirements specified by the Financial Advisory and Intermediary Services (FAIS) legislation. Following the promulgation of the legislation, the Financial Services Board (FSB) agreed that FAIS, which is designed to protect retail investors, is not necessarily compatible with the needs of the wholesale or institutional investor base seen in private equity. "As a result the FSB agreed that private equity would fall within a separate licensing category, created specifically for private equity," Dreyer says. This category is in the process of being created.

A healthy state

Private equity practitioners argue that the many layers of legal and regulatory requirements represent a notable cost burden for the industry – one that potentially could crowd out smaller firms who lack the resources to employ additional reporting and compliance staff, or to outsource these vital functions.

Despite the challenges, the industry has maintained a positive and constructive approach to policy and legal changes that influence the way in which business is done. This approach is exemplified in the heightened role for SAVCA: In the years since its inception, SAVCA has become more deeply involved in discussions with regulators, policymakers and legislators, to ensure its voice is heard alongside other more dominant bodies representing far larger industries.

As Dreyer puts it, while there always is work to be done in this area, active and frank engagement with the regulatory authorities has ensured that the private equity industry today is in a healthy space.

From the media archives:

Doubt cast on validity of sudden tax change

BY SANCHIA TEMKIN
6 August 2012

IT IS questionable if the Treasury's suspending of section 45 of the Income Tax Act will pass constitutional muster.

After capital gains tax was introduced in 2001, the government announced revised group relief measures for companies. Section 45 was intended to facilitate transfers among companies that constituted a group, whether such transfer took place by way of an exchange of shares, debt or cash, or as a dividend.

The manner of the suspension of the section early this month –without prior notice to taxpayers and other interested stakeholders – is draconian and undermines the rule of law in so far as SA's tax system is concerned, tax analysts say. "The suspension placed on section 45 undermines the relationship between taxpayers and the government. The government does not trust taxpayers and tax practitioners," says Beric Croome, a tax executive at corporate law advisers Edward Nathan Sonnenbergs.

Source: Business Day

A legal regulatory timeline for South African private equity

Year	Event	Description
1995	Thin capitalisation and transfer pricing	Section 31 of the South African Income Tax Act, 1962, is introduced to limit the deductibility of interest if there is a disproportionate ratio between loan capital and equity in certain circumstances, and to adjust the prices of goods and services in terms of certain transactions concluded between connected persons, to reflect an arm's length price.
1998	Competition Act, 1998, is promulgated (comes into full effect during 1999)	
2001	Capital gains tax	Capital gains realised on disposal of assets become subject to normal tax and the provisions of the Eighth Schedule.
	Corporate rules	Sections 42 to 47 of the South African Income Tax Act introduce tax roll-over relief for transactions between group companies, or founding shareholders and their company.
2002	Financial Advisory and Intermediary Services (FAIS) Act, 2002, is promulgated	
2003	Broad-Based Black Economic Empowerment Act (B-BBEE), 2003, is promulgated	
2007	Codes of Good Practice	The B-BBEE Codes of Good Practice are published. These Codes encourage companies in South Africa to implement black economic empowerment initiatives against which they are scored and obtain a B-BBEE recognition level. The Codes of Good Practice introduce criteria for the recognition of shareholding through a private equity fund and being ownership held by black people.
2009	Special dispensation for Venture Capital Companies	Section 12J of the South African Income Tax Act introduces a deduction of expenditure actually incurred in acquiring venture capital shares.
	Intra-group transactions: Closure of disguised sales	Section 45 is amended to limit the misuse of intra-group relief.
2010	Exchange control approval for African investments	In support of the broader strategy to make South Africa the gateway into Africa, private equity funds mandated to invest into Africa may apply to Exchange Control for an annual approval, subject to certain conditions.
2011	Companies Act, 2008, is promulgated	The Companies Act, 2008 comes into force on 1 May 2011. One of the material changes brought about by the New Act is that fundamental transactions (for example, disposal of all or a greater part of the company's assets or undertaking, amalgamations or mergers and schemes of arrangement) require the approval by special resolution. In addition the New Act provides greater remedies for minorities who dissent against such special resolution.
	Revised Regulation 28	Revised Regulation 28 that gives effect to section 36(1)(bB) of the Pension Funds Act, 1956, comes into effect. Regulation 28 prescribes limits for various types of investment that may be made by a retirement fund and was promulgated in order to guide funds that invest in their own name. Notably, the key amendment for private equity is that pension funds are allowed to invest up to 10% of contributions into private equity funds; this is an increase from the previous limit of 2.5%.
	Promulgation of the Alternative Investment Fund Managers Directive ("AIFMD")	The AIFMD is a European Union Directive aimed at increasing investor protection and reducing systemic risk by establishing a harmonised EU framework for regulating alternative investment fund managers.
	Proposed suspension of intra-group transactions and intra-group debt subject to approval	National Treasury proposes to suspend section 45 of the South African Income Tax Act, but opts for the introduction of section 23K to limit the deductibility of interest.
2012	Dividends Tax	Dividends Tax is introduced, which moves the taxation of dividends from company level to shareholder level. The rate of taxation is increased to 15%.
	Financial Sector Charter	The Financial Sector Charter is published to regulate black economic empowerment in this sector.
2013	Revised Codes of Good Practice	The DTI publishes revised B-BBEE Codes of Good Practice. The Revised Codes rationalise the pillars against which companies are measured to ownership, management control, skills development, enterprise and supplier development and socio-economic development. Ownership becomes a priority element together with skills development and enterprise and supplier development including sub-minimum thresholds need to be achieved in each of these pillars. The Revised Codes of Good Practice expand on the criteria for recognition of shareholding through a private equity fund being ownership held by black people.
	FATCA Inter-Governmental Agreement signed	USA and South Africa enter into an inter-governmental agreement. This legislation requires South African financial institutions to exchange information with SARS, which SARS will then exchange with the US in terms of the legal framework provided for in the relevant double taxation agreement.
	Revised interest limitation rules	Section 23N of the South African Income Tax Act is introduced and limits the deduction available in respect of interest incurred in financing reorganisation and acquisition transactions, with specific reference to section intra-group transactions and liquidation distributions.
2015	Revised interest limitation rules	Section 23M of the South African Income Tax Act is introduced and limits the deduction available in respect of interest incurred on debt owed to a person not subject to tax in South Africa (including persons exempt from tax such as pension funds)[1].
	Withholding tax on interest	Section 50A of the South African Income Tax Act is introduced to impose tax on interest paid to non-resident persons at a rate of 15%.
2016	Withholding tax on service fees	Section 51A of the South African Income Tax Act will come into operation and imposes tax on technical, managerial and consultancy fees services paid to non-resident persons at a rate of 15%.

[1] Amendments proposed in 2014 Taxation Laws Amendment Bill, which has not been promulgated at date of printing.

Source: Webber Wentzel

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A move towards the mainstream

The success of South African private equity was ensured from early on by substantial institutional support for and allocation to it. Initially, interest was limited to domestic funders, but later broadened to include North American, European and Asian institutional investors. Statutory amendments in South Africa, by way of the 2011 changes to Regulation 28 (described in more detail below), have stimulated further interest amongst domestic pension funds. However the industry still has much work to do to effectively market the benefits of the private equity asset class to a broader range of local and international pension funds, family offices, development finance institutions and other wholesale investors.

From a private equity perspective, one of the most notable aspects of regulatory reform in the South African financial industry in recent years was the implementation in July 2011 of changes to Regulation 28, under Section 36 of the Pension Funds Act of 1956. Following years of lobbying by SAVCA, through its Regulatory Sub-Committee, the prescribed allocation by pension funds to private equity was ramped up from 2.5% to 10% of the aggregate fair value of total assets of the fund.

The move was hailed widely as a breakthrough for the private equity industry.

Quoted in the months before the implementation, RisCura's Rory Ord explains the significance:

"[T]he fact that private equity has been specifically defined, and has been allowed a significant allocation, means that pension fund trustees must now specifically consider their approach to investment in this area. The previous categorisation, as part of a small "alternatives" and "other" classification, allowed trustees to consider this area insignificant. The increased emphasis and guidance in the Regulation will also give trustees increased confidence that investing in unlisted companies is not only good from a portfolio management point of view, but is specifically sanctioned by the Regulator" (Catalyst, Fourth Quarter, 2010).

Despite the opportunity created by this amendment to Regulation 28, take-up to date has been somewhat limited.

Dave Stadler

"It is a relatively new amendment, and a great deal of work still needs to be done to convince local pension funds of the attractiveness and appeal of private equity as an essential alternative asset class," says Dave Stadler, CEO of Paean Private Equity. "Offshore pension funds generally have a greater appetite for private equity than South African pension funds, and understandably so, as the private equity industries there are more developed."

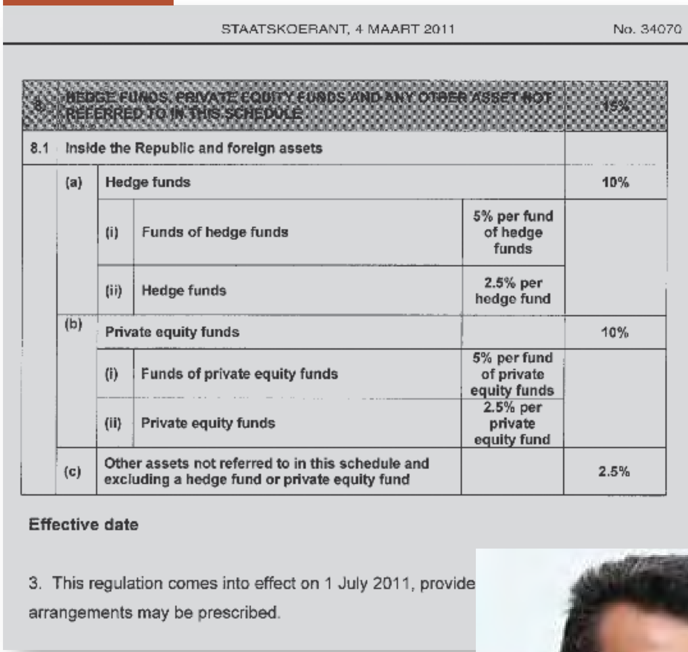
Referring to the approach by global institutional investors to private equity, Hemal Naran, head of Investment and Actuarial at the Government Employee Pension Fund (GEPF), says: "Clearly the US has been the leader, with US pension funds having allocations in the mid-teens to over 20% of assets under management. This contrasts significantly with European pension funds, where allocations are in the

Private Equity's Place in GLOBAL INSTITUTIONAL PORTFOLIOS

Peter Schmid, a partner at Actis, notes the enthusiastic interest in private equity amongst North American institutional investors. Familiarity with the asset class following multiple decades of investment, consistent outperformance relative to listed equity and the more recent drive to ensure that institutional funds deliver adequate returns in a low-growth context, have kept private equity top of mind. "US investors are looking for yields of 6% to 7% on a net basis, and this is coming from private equity rather than the public markets. So the asset class is appealing to a vast range of investors".

Referring to the approach by global institutional investors to private equity, Hemal Naran, head of Investment and Actuarial at the Government Employee Pension Fund (GEPF), says: "Clearly the US has been the leader, with US pension funds having allocations in the mid-teens to over 20% of assets under management. This contrasts significantly with European pension funds, where allocations are in the low single digits. And pension fund investors in other regions tend to have relatively immature portfolios with regard to private equity investments."

From the archives:



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8	HEDGE FUNDS, PRIVATE EQUITY FUNDS AND ANY OTHER ASSET NOT REFERRED TO IN THIS SCHEDULE			15%
8.1	Inside the Republic and foreign assets			
(a)	Hedge funds			10%
	(i)	Funds of hedge funds	5% per fund of hedge funds	
	(ii)	Hedge funds	2.5% per hedge fund	
(b)	Private equity funds			10%
	(i)	Funds of private equity funds	5% per fund of private equity funds	
	(ii)	Private equity funds	2.5% per private equity fund	
(c)	Other assets not referred to in this schedule and excluding a hedge fund or private equity fund			2.5%

Effective date

3. This regulation comes into effect on 1 July 2011, provide

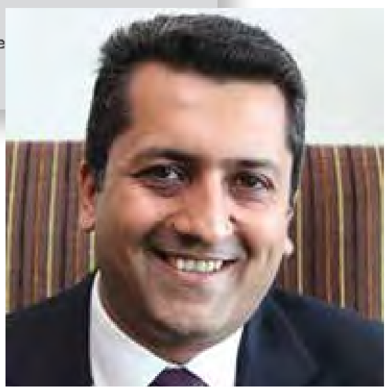
arrangements may be prescribed.

low single digits. And pension fund investors in other regions tend to have relatively immature portfolios with regard to private equity investments."

"The fact that private equity returns, as an asset class in general, has a low correlation with the returns from most other asset classes, provides substantial benefits to pension funds in the construction of their portfolios," says Emile du Toit, head of Infrastructure Investments at Harith General Partners. "Private equity also has the benefit of allowing investment in businesses and assets that aren't ordinarily accessible through listed markets or otherwise, such as infrastructure or large family-owned businesses."

Du Toit is keen to see smaller pension funds participating in private equity investment, as they too should be able to diversify their risk. "It would be good to see a greater presence of intermediaries and fund-of-fund vehicles which could facilitate this: Given the minimum investment criteria for allocations to private equity fund structures, direct investment into private equity funds currently is the preserve of large pension funds."

Stadler is confident that the research, training and marketing done by the private equity industry ultimately



Hemal Naran

will pay off. "We believe that, through consultation and education, particularly between SAVCA, private equity fund managers and pension funds, we will see private equity become an increasingly attractive asset class to a far broader range of retirement funds and their trustees."

From the archives:

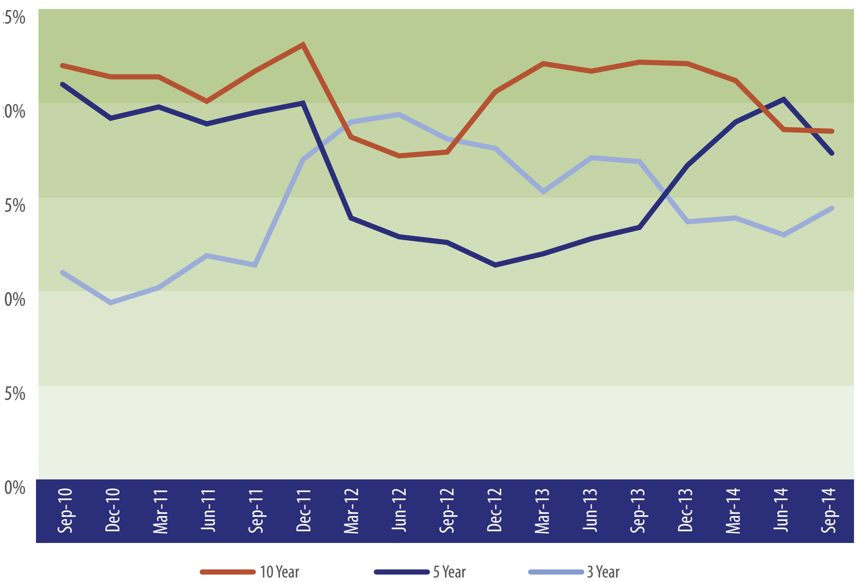
Extract from... Is private equity a suitable investment for South African pension funds?

By I. Missankov, R. van Dyk, A. van Biljon, M. Hayes and W. van der Veen; Presented at the Convention of the Actuarial Society of South Africa, October 2006

"While the results of the investigations should not be treated as conclusive, they certainly point to benefits for pension funds which invest in private equity. Expected investment performance and diversification benefits should be powerful drivers for the allocation of assets to private equity investment, as should be the opportunity to meet BEE objectives. The investment horizon of private equity investment, in particular, is especially suited to the long-term nature of pension funds. Liquidity should not be a significant concern, assuming a relatively low allocation of 5% of assets and what appears to be a substantial liquidity premium."

Steady Private Equity Returns

Quarterly pooled internal rates of return; data for South African funds

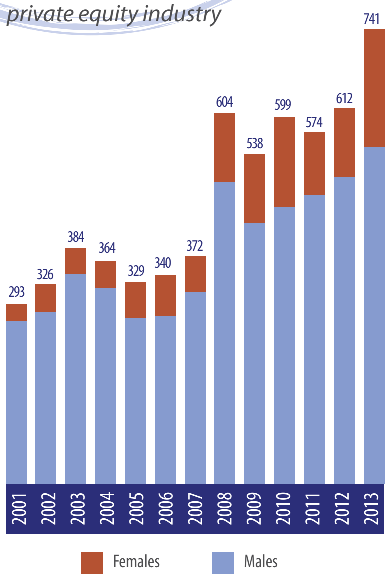


Source: Riscura-SAVCA South African Private Equity Performance Report January 2015

It's a people's industry, after all

Tracking Talent

The proportion of male and female professionals in the South African private equity industry



Source: SAVCA-KPMG Private Equity Industry Survey, various years

The South African private equity industry employed 741 professionals in 2013. At any point in time, dozens more are clamouring to enter the industry, whether as employees, or by starting their own private equity or venture capital funds. Private equity practitioners who have been at it for many years – having seen ebbs and flows, abundance and hard times – caution that survival requires not only a specific set of technical skills, but particular personality traits.

It could be the apparent glamour of private equity, created by Hollywood scripts and bestselling books, that perennially draws financial graduates to hunt for jobs in the industry. Few manage to find the desired posts; those that do, learn quickly that it is a game of perseverance, unpredictability and skill.

Dave Stadler, CEO of Paean Private Equity, cautions those looking to private equity as a career choice, warning that positions are not readily available. "It is not easy to break into this environment. Fund management firms usually have small teams, normally with fewer than ten professionals. There is also a low turnover in these teams, owing to the carried interest structure which incentivises team members to stay for the long-term rewards. On the rare occasion when a private equity firm is recruiting, it is usually looking for specific skills or knowledge to supplement the skills of the current team."

> *You have to be a very persuasive person. In the interests of striking a deal at the right price, you sometimes need to be forceful – and sometimes not. There is also a large helping of ego and ambition involved. Private equity people tend to have strong personalities which comes through in their business activities. They have a mix of entrepreneurial and corporate executive qualities. They are competitive and focused on winning.*
>
> *Antony Ball*

A broadening portfolio of talent

The predominant qualification in the South African private equity industry is chartered accounting. In recent years, though, with the expanding emphasis on operational enhancements and value creation in portfolio companies, there has been a gradual incorporation of other professionals into teams, including engineers, MBA graduates and management consultants. The burgeoning regulatory burden has also shaped the skills sets sought by fund managers.

Neil Page, managing director of RMB Corvest, confirms that the industry was dominated from the early years by what he terms "pale-male chartered accountants", but that in recent years new recruits have included blacks and women – and a more diverse skills set alongside the accountants. "These additional skills and diversity of thinking are invaluable as the initial investment-appraisal system has become more complex and sophisticated. And there are now many more issues requiring evaluation – besides only the numbers. The nuances and interpretations required with respect to competition regulation are one example."

Other regulatory and legislative elements have added to firms' hiring requirements, too. Chad Smart, a co-founder and the chairman of Capitalworks, explains that, "in the early days you simply focused on getting the deal done; today's teams require a tremendous skill set and maturity around understanding, implementing and complying with various governance and administration criteria. Previously, this used to be an add-on, now it's probably a core competency in a deal".

On moving away from the traditional hires, Sphere CEO Itumeleng Kgaboesele says: "While we look for predominately financial skills, these recruits are not necessarily chartered accountants. We are increasingly also looking for operational experience, bringing these skills in on a part-time consultancy basis. We also believe strongly in the importance of diversity within the team to bring new perspectives and to be gender representative."

People skills count

Soft skills, then, have always been and will continue to be important in private equity.

As Stadler puts it, "private equity practitioners are there for the very long haul and participate across the spectrum of entering into a deal, then creating value and culminating in the exit. It requires extensive insight into many aspects of human behaviour – and negotiating skills are paramount."

Antony Ball, a prominent figure in the history of South African private equity and now chairman of Rockwood, is forthright about the personality requirements for survival. "You have to be a very persuasive person. In the interests of striking a deal at the right price, you sometimes need to be forceful – and sometimes not. There is also a large helping of ego and ambition involved. Private equity people tend to have strong personalities which comes through in their business activities. They have a mix of entrepreneurial and corporate executive qualities. They are competitive and focused on winning."

Chartered accountant and co-founder of Metier, Anthony Hewat, alerts aspirant practitioners as to how tough the industry can be at times. "Investors will not always appreciate the battle scars of decisions you made which did not work out well – even though you learned major lessons from these events. They will judge you for losing a little, rather than acknowledge that in fact you preserved a great deal of value during very difficult times. This particular investor community can be quite intolerant of losses – in contrast with the listed environment where, when mistakes are made in a particular reporting period, the focus simply moves on to the next round of reporting. You have to be resilient to enjoy this industry."

Claire Busetti

Claire Busetti, an independent industry professional, agrees that the long-term nature of the industry has its downsides. "Institutional investors can be unforgiving partners and any mistakes on your part will stay with you for years."

Busetti argues, too, that the industry is not for those who want to manage by remote control and who are not willing to roll up their sleeves. "Private equity

FUND SNAPSHOT

Metier

Metier Investment and Advisory Services ("Metier") was founded in 2004 by Thierry Dalais, Paul Botha and Anthony Hewat.

First fund closed in 2006/7:
Mandate: Mid-market growth and replacement capital (entrepreneur partnering, platform build ups)
Investors/LP's: South African and international institutions, pension funds and family offices.

Most significant investment:
Liberty Star Consumer Holdings (Libstar), an unlisted food and personal care manufacturer. Good example of our platform investment style based on an in-house developed investment thesis.

THE PRINCIPLES OF DOING PRIVATE EQUITY

"Some of the basics of private equity have remained constant despite the industry's notable evolution," says Dave Stadler, CEO of Paean Private Equity and SAVCA chairman. "One of these constants, and at the heart of successful private equity, is the investment premise which is to catch the growth cycle of a portfolio company. We always need to get on board at the right time, and then we must add value, implement strategy and align our interests with those of company management. We reorganise management if required; restructure the balance sheet; sell non-core businesses or buy add-on operations; enter new markets or exit others; and instil appropriate corporate governance. The goal is to create a quality company so that divestment is easier, and capital realised can then be deployed in the next well-timed acquisition. These basic principles have remained intact throughout the decades."

is a great career for people who love being involved in a multitude of things. I consider it to be a good profession for a polymath who has good judgement."

> *I consider it to be a good profession for a polymath who has good judgement*
>
> *Claire Busetti*

She feels strongly that to be exceptionally successful in private equity, one has to be deeply involved in all aspects of the process. "One trend that concerns me is the outsourcing of the due diligence process. The risk is that a superficial checklist approach is used, and those doing this for you earn the fees and never live with the consequences. This corporate-finance or consulting-type approach doesn't go deeply enough; good fund managers stay close and get their hands dirty, in the initial stages of a deal, as well as thereafter. There has to be constant monitoring of and adding value to the investee business, with a particular focus on managing the relationships. The soft side goes straight to the bottom line and the vast majority of the work is done after the cash changes hands."

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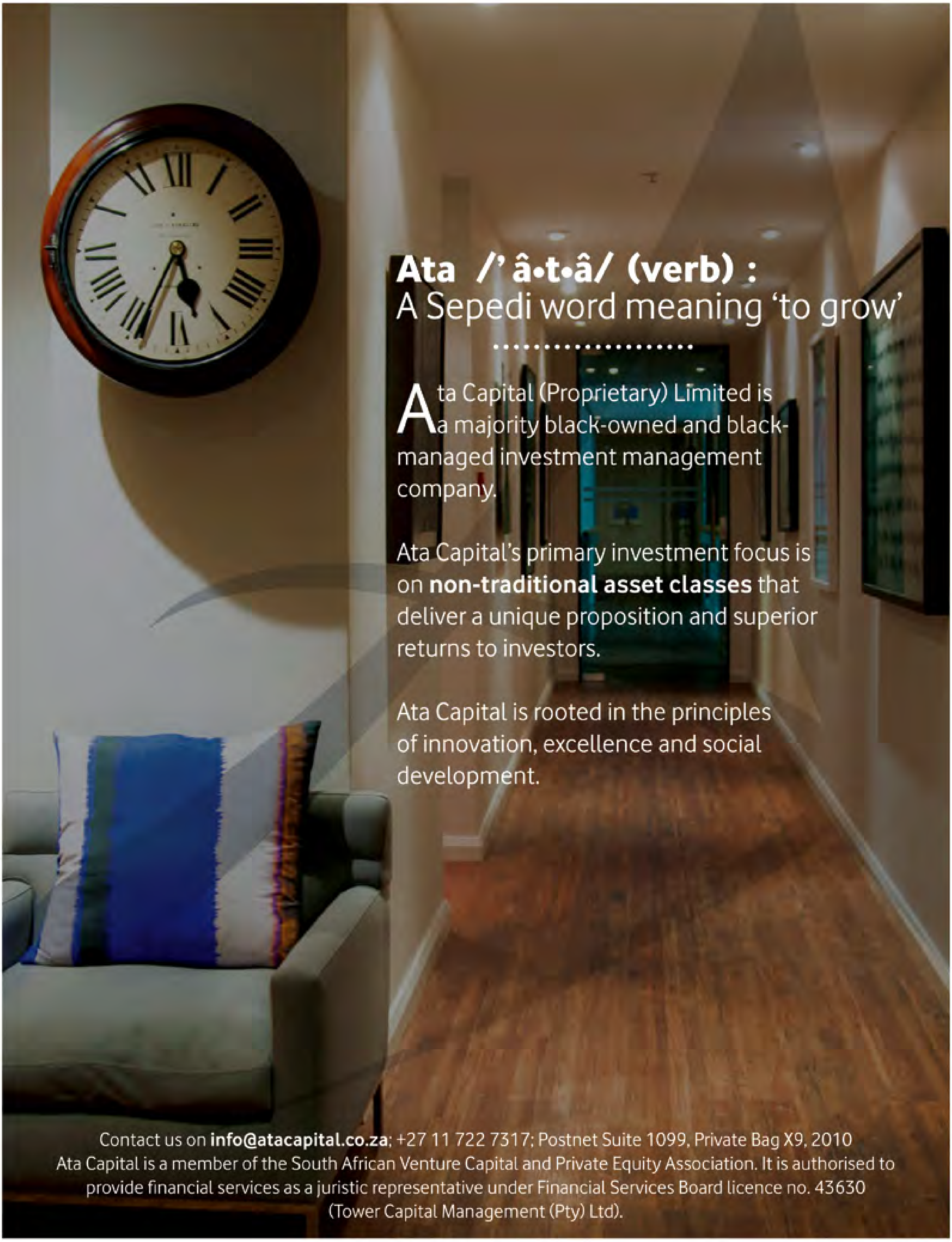

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Venture capital endeavours

From the media archives:

VeriSign Buys South Africa's Thawte for $575 Million

BY STEVEN LIVERSEDGE
23 December 1999

South African Internet certification company Thawte Consulting announced this week that the company has been sold to VeriSign for R3.5 billion ($575 million) in an all-stock deal.

The Cape Town-based company is the second largest provider of digital certification for the Internet in the world, with VeriSign being at the top of the heap, and the deal will consolidate the US company's hold on the global Internet certification market.

The deal is a major coup for Thawte's 26-year-old chief executive Mark Shuttleworth, who established the company only four years ago. It has since grown to become the second largest Net security company, behind VeriSign. Thawte also has established agency networks in 22 countries worldwide.

Source: InternetNews.com

Malcolm Segal

Since the early mining days South Africa has had a history of entrepreneurship, a willingness to take and back risk and a talent for innovation. Whilst this has spilled over into a nascent venture capital industry, particularly from the late 1990s onwards, industry players lament the still limited development and lack of institutional and government backing for the venture capital asset class. The industry nevertheless boasts a number of successes, each of which confirm the potential of South African venture capital.

"Compared with traditional private equity in South Africa, which is mature and sophisticated, and has accumulated great critical mass over the decades, the local venture capital industry is still relatively underdeveloped," says Malcolm Segal, non-executive chairman of Grovest, a Section 12J venture capital company.

Segal has extensive experience in private equity, and has recently moved into the venture capital segment of the market. His view is that the South African venture capital ecosystem is developing slowly but at an encouraging pace. "The percentage of investment capital allocated to it is still extremely low, but investor appetite is increasing and we are seeing some good success stories."

He recalls a few local high-profile cases in the past that left investors badly hurt, an unsuccessful VC board on the JSE and tax legislation that generally was not investor friendly for venture capital, all of which tainted perceptions of, and support for, the industry.

"But cynicism is starting to dissipate," says Segal. "For instance, investors began taking note when Mark Shuttleworth sold his IT business at the start of the millennium with great financial success."

Limited institutional support

Claire Busetti, an independent industry professional with widespread experience in both venture capital and private equity, is a little more circumspect in describing the performance of the South African venture capital industry, pointing out that it still lacks the financial support of pension funds and other key institutional investors.

"The South African situation contrasts with the huge and continued government support for venture capital in markets such as the USA, Canada, China, Saudi Arabia, Russia, Australia, India, Israel and Brazil. In these various jurisdictions, the public sector has set up and funded private-sector-managed venture capital programmes, as there is appreciation for the importance of facilitating innovation and the growth of new small businesses, which in turn enhance economic growth and provide employment."

Much of the support for South African venture capital comes from high-net-worth individuals – successful entrepreneurs in their own right, who have an appetite for and an understanding of risk and innovation. Examples of individuals providing this energetic and visionary backing for venture capital structures are Mark Shuttleworth, through HBD Ventures, the SAP co-founder Hasso Plattner, via Hasso Plattner Africa, Michael Jordaan, who recently founded Montegrey, and the Rupert and Oppenheimer families, through 4Di.

A further route used by established and successful entrepreneurs to fund innovation in South Africa is so-called angel investing – investing directly into early-stage opportunities rather than via fund structures. Emerging angels with recent experiences and success in technology and start-ups are adding their weight to a long history of behind-the-scenes high-net-worth angel investing, working closely with young talent in this way; notable names include Hannes van Rensburg, the founder of Fundamo; Willem van Biljon, who founded Postilion and Nimbula; the Clickatell founder, Pieter de Villiers, and Vinny Lingham, who set up Yola and Gyft.

Emerging signs of success

With limited resourcing, the South African venture capital industry nevertheless has delivered numerous successes, each of which highlight the potential of this market.

Samantha Pokroy, founder and CEO of Sanari Capital, refers to the Ethos Technology Fund's investment in the mobile messaging and transacting business, Clickatell, which achieved Silicon Valley backing from world-leading VC, Sequoia Capital. There are also well-known exits, including HBD-backed Fundamo and CSense, which were sold to Visa and General Electric respectively, the sale of One Digital Media to a consortium including RMB Ventures and Bopa Moruo, and Via Media's sale to Blue Label Telecoms. "There was also the notable recent sale by Treacle Private Equity of Teraco to London-based Permira, resulting in the first large-scale investment by a major international VC firm in the South African market."

On assessing success, Pokroy is philosophical, noting that, "success in VC should be measured differently in South Africa. In large and highly developed VC markets like Silicon Valley, it becomes a numbers game, where a few massive successes offset a great number of failures and write-offs. With the current small size of the start-up market in South Africa, and the still-developing skills base in both tech and general entrepreneurship, local venture capital fund managers have fewer opportunities with which to work and are therefore compelled to manage their risks and portfolios more carefully".

Keet van Zyl, co-founder of Knife Capital, provides some context on perceived risks associated with VC: "While it is true that the mortality rate of startups in South Africa is considerably high, the failure rate of VC portfolio companies is comparatively much lower. This is partly because of the lack of supply of risk capital in the country, combined with active VC portfolio management. Start-ups with traction attract attention and due diligences are more thorough. So, the companies that do eventually get VC funded have risen above the rest. Exits take a bit longer but generally entry valuations are not over-inflated by hype, so that balances out".

Pokroy also highlights the impact of the regulatory landscape, which "has not always been conducive to supporting early-stage investments with global prospects. Nevertheless, through work by SiMODiSA, a public-benefit industry organisation working with government to enhance the entrepreneurial ecosystem, this should improve".

Pokroy is upbeat about a better future for South African venture capital. "As the VC and start-up industry develops, grows and matures on the back of investment, skills development and experience, the prospects for successful innovation in the South African market grows substantially".

A VC timeline

Busetti traces the emergence of the contemporary South African venture capital market back to the late 1990s,

Keet van Zyl

From the media archives:

Less risky

BY MARC ASHTON and SIMON DINGLE
23 June 2011

The South African venture capital sector has received a much-needed shot in the arm with the announcement that international financial services giant Visa has acquired Cape based start-up Fundamo for US$110m. Fundamo is a platform provider of financial services for mobile network operators.

The deal comes hot on the heels of the April announcement that Pretoria-based CSense systems would be acquired by GE Intelligent Platforms and that Horizon Equity Partners was able to sell its investment in Peresys to Australian firm IRESS for R375m in January.

Fundamo, whose shareholders include the likes of Sanlam, Remgro and HBD Capital, negates the argument that major technology businesses with worldwide appeal can't be built in SA.

Source: Fin24.com

Samantha Pokroy

when markets were very heated. "Several players went into VC then, with institutional backing. At the time, neither the fund managers nor their backers had the experience needed for this to take off substantially."

Stephan Lamprecht of Venture Solutions recalls those days, confirming that it was only by the late 1990s that a recognised venture capital industry emerged in South Africa. "Big fund managers such as Brait and Ethos created tech funds, development finance institutions put money into VC funds, and Venfin was very active in playing a VC role, through its involvement in the early days of Vodacom and eTV, for example."

The dot.com crash was followed by a hiatus of three to four years, following which a second phase of venture capital investing began. "Shuttleworth's Here Be Dragons investments, and especially the public campaigns to evangelise entrepreneurship and start-up skills through the Big Idea initiatives, kept venture capital alive when nobody, not even government, wanted to touch anything left over from the dot.com saga," Lamprecht says. He goes on to explain that a number of venture capital funds were founded, with support from amongst others the IDC, the Department of Trade and Industry, and the Department of Science and Technology. At the same time, private sector support arose, including from Shuttleworth and later Hasso Plattner.

Recent interest from institutions and other organisations focused on entrepreneurial businesses has resulted in a number of new venture capital entrants, which is creating a healthier and more vibrant venture capital ecosystem, which in turn translates into a more dynamic and supportive entrepreneurial ecosystem.

"Thanks to participants such as Remgro's Invenfin, Michael Jordaan, the VC unit of the IDC, funds such as Business Partners, and also some of the funding banks, VC is increasing its profile and people are recognising the important contribution this sector can make to the economy," Segal says.

Busetti cites further positive developments, amongst them the emergence of the incubator space, and the move to BEE codes and enterprise and supply-chain development, which is putting money into the high-risk start-up and SME space.

Business incubators and accelerators have become important launch pads for young businesses in South Africa. Through coaching and networks, they help companies get through key growth stages to make them more sustainable and fundable. Programmes like Raizcorp, Aurik, 88mph and Knife Capital's Grindstone have produced tangible results in bringing about growth in their incubatees. Grindstone radar start-up iKubu was recently acquired by GPS giant Garmin, validating the impact these programmes can have on assisting SMEs to scale up.

Intrepid VC spirit

"There always seems to be an interest in VC in South Africa and, if you stand back, it has been remarkable to what extent the industry has survived and developed," Lamprecht says.

He sees the future of South African venture capital as being intricately tied in with exciting technology developments further north, including in West and East Africa.

"There is a great deal of 'African-ness' about the future of VC: If you consider investment opportunities beyond South

From the media archives:

The tech companies Michael Jordaan has invested in through investment firm MonteGray Capital.
Moneyweb, 30 January 2014

Yola boss Vinny Lingham steps down to launch new startup
Ventureburn, 3 August 2012

Convergence Partners invests in 4Di Capital
BusinessTech, 19 February 2014

South Africa's greatest tech exports
BusinessTech, 6 August 2014

Via Media deal will boost sales, says Blue Label
Business Day, 12 August 2014

Oracle to buy private cloud startup Nimbula
ITProPortal, 14 March 2013

Permira Buys Africa's Teraco Data for Undisclosed Price
Bloomberg, 4 December 2014

Garmin acquires SA start-up iKubu
Techcentral, 14 January 2015

RMB Ventures and Bopa Moruo invest in One Digital Media
Engineering News, 20 October 2014

Mark Shuttleworth scores big in Fundamo deal
Techcentral, 9 June 2011

Ethos supports Clickatell's mobile messaging expansion plans
IT-Online, 23 March 2009

Africa, there is enormous interest from potential backers." Naspers and Paypal, for instance, are active investors into venture capital technology in various parts of Africa. "Tech-hungry and cash-rich corporations, from telecommunication businesses and media, all the way to banks and life assurers, are seeking VC-type investments with which to gain rapid market share and to offer suitable products for the growing African consumer market."

A brief history of the IDC's venture capital track record

"With the increased interest in the technology sector in 1999-2000, the IDC made the decision to get involved in the industry, particularly to assist small start-up companies," says Paul Johl, senior account manager at the IDC's Venture Capital Strategic Business Unit. "As we didn't have the expertise to do this type of investing on our own, we went the route of investing into funds."

Between 1999 and 2001 the IDC approved and saw the establishment of four technology funds, each of which were allocated R75m in capital.

"With the bursting of the tech bubble we extended our scope from IT and ICT to broader technology and other themes and, over the next three years, we facilitated two empowerment funds, a biotech fund, a junior mining fund and the Women Entrepreneurial Fund," Johl says.

The IDC's commitment to these nine funds reached just shy of R600m, with additional funding support from the likes of the Eskom Pension and Provident Fund, the DBSA and international DFIs taking the institutional investment up to around R1.7bn.

"Two of these nine funds did quite well, two did poorly and some had mixed outcomes," according to Johl.

Following an internal decision that it would halt its programme of investing on a wholesale basis through venture capital funds, the IDC in April 2007 established its Venture Capital Strategic Business Unit, bringing its venture capital activities onto the balance sheet. Its mandate would be to invest in globally unique technology of South African origin.

"This new unit invested the initial R250m allocation in under four years," says Christo Fourie, head of the IDC's Venture Capital Strategic Business Unit. More top-ups followed, with R500m allocated at the end of 2010 and a further R150m allocated in August 2014. "We have invested around R750m since 2007, in thirty-seven new companies in various stages of maturity. Many of these entities are now self-sustaining and thinking of an exit."

Fourie is philosophical about his team's achievements, pointing out that it is the nature of venture capital to face much failure. "We have had nine liquidations or orderly wind-ups and one sale at cost. Our efforts are now directed at getting ready for our first exit that will yield a positive return."

Christo Fourie

Paul Johl

From the media archives:

SA's medical device makes 'Grey's Anatomy' debut

BY ZANELE SABELA
11 June 2013

Chief executive of the South African company that manufactures the x-ray machine featured on US television show Grey's Anatomy is unperturbed by the attention the company has been getting.

Designed, built, and distributed in South Africa, the device scans the entire body of a patient in 13 seconds – a procedure that would take around 20 minutes with conventional x-rays.

The Sandton-based company employs 27 people in SA and four in the US. Longstanding shareholder Industrial Development Corporation (IDC) took up a majority stake in the company in 2010 and continues to support and fund ongoing research, development and product improvements.

Source: Destiny Man.com

An African dream gains substance

FUND SNAPSHOT

Actis

Actis was founded in 2014. Many members of the Actis management and investment teams had worked at CDC and brought years of experience in investing across Africa, Asia and Latin America.

Date in which the first fund closed:
July 2004

Mandate:
Actis invests exclusively in the emerging markets, with a growing portfolio of investments in Asia, Africa and Latin America; it currently has US$6.5bn funds under management. Combining the expertise of over 100 investment professionals in nine countries, Actis identifies investment opportunities in three areas: private equity, energy and real estate. Africa lies at the core of the firm's investment strategy. Today, over 40% of Actis's investments are located in Africa, with over $1.5 billion invested across 13 countries on the continent.

Most significant investment in South Africa and why:
Alexander Forbes: Going into the transaction, it was the second-largest delisting that South Africa had seen; the exit process represented the third-largest listing ever done in South Africa. It was also the first deal that we had done in South Africa and was very high-profile in nature.

Three biggest changes since those early years:
- In 2004, Actis had one investor and $1bn in assets under management; today, it has 212 investors and US$6.5 billion assets under management.
- Transitioning to sector focus.
- Becoming a leading global firm.

Compared with the early pioneering work of some of South Africa's listed corporates, who led a bold expansion north of the borders, South African private equity firms adopted a more conservative approach to increasing their regional reach. It has been only in recent years that a notable shift in fund mandates has been observed, incorporating planned deals in African markets beyond South Africa. Largely, though, the form of gaining exposure to other jurisdictions has been through fund managers guiding portfolio companies in cross-border portfolio expansions.

International private equity players continue to dominate the continent outside of South Africa and, for most South African private equity funds, a regional African theme is still not a meaningful component of their strategy.

For an industry focused on a demanding home market, it has been a daunting task to tackle new economies. An early and high-profile setback, by way of Oceanic Bank, the Nigerian deal in which a consortium including Old Mutual and Ethos was invested, may well have added to the circumspection.

Steep learning curve

Paul Boynton, CEO of Old Mutual Alternative Investments, says the deal prompted a great deal of learning and introspection, especially considering the past successes Old Mutual has experienced on the continent. "We did very well with Celtel, and our African infrastructure investments, such as rail in Zambia and Zimbabwe, and an airport in Tanzania, were equally successful. This challenging transaction required us to reassess our approach to and pricing of risk in Africa."

He points out that one of the lessons from this experience is to ensure deals have the support of a strong local presence. "We have not been deterred and Old Mutual continues to look at Africa for private equity opportunities, with a deeper comprehension of the risks and how to mitigate them."

Despite a slow start, South African private equity funds now are considering their African options in earnest. Limited economic growth in the domestic market and a broad range of growth and returns opportunities in West, East and Southern Africa are drawing managers northwards.

Sandeep Khanna

Sandeep Khanna, a managing director at The Abraaj Group, says that "a number of South African-based GPs have, over the past five to seven years, moved hesitantly into the rest of the continent, with varying degrees of success – and with varying perceptions of risk versus rewards. Today, partner companies expect this value addition from private equity to open up the markets and to provide networks and opportunities to expand their business on the African continent".

Indeed, this strategy for Africa, namely that of ensuring operational expansion in key African markets, is already pervasive in many private equity portfolios.

Sphere Holdings CEO Itumeleng Kgaboesele says his operation is working closely with management teams to craft African strategies. "We're also spending time and resources to understand the different regions. We have invested significantly in building relationships in East and West Africa. This approach makes sense to us, compared to buying stakes in companies outside of our borders. Despite the tougher economic conditions, we believe that there are still great investment opportunities in South Africa."

Peter Schmid, partner at the emerging markets private equity firm Actis, cites the firm's recent Tekkie Town deal as a good example of taking a South African portfolio company into other African markets. "The low-cost model of this business is ideal for Nigeria, perhaps even for the North African countries such as Egypt and Morocco." Based on Actis's extensive deal-making experience across Africa, which includes its successful role in Celtel, Alexander Forbes, Vlisco, Actom and BCR, Schmid cautions, though, that finding experienced and high-quality management teams for such a cross-border expansion drive is a notable challenge faced on the continent.

Although it has done a Nigerian deal and has been invested indirectly in more than thirty African countries since the early 2000s through a number of its investee companies, RMB Corvest describes its African strategy as a cautious one. According to Dick Merks, "Our strategy at present is about getting a feel for the continent, and, so far, we have struck one deal, Vital Products in Nigeria. It is hard work and quite difficult to find quality businesses with proper records. At this stage, we are keen on finding entrepreneurial, family-sized businesses that will give us exposure to the middle-income consumer base."

Local talent the lifeblood of an African strategy

Capitalworks, a leader as a South African-based private equity fund manager in establishing a separate fund with a mandate covering sub-Saharan Africa (excluding South Africa), closed its African Special Opportunities Fund in 2009.

"These certainly were the early days for local fund managers to look north; since 2010, we've seen growing investment activity by South African funds outside South Africa," says Chad Smart, co-founder and chairman of Capitalworks.

This fund, which Smart describes as having a very people-intensive approach, focuses on the small mid-market space, with deals usually in the \$8m to \$10m range. The methodology of Capitalworks' Africa fund is also somewhat different from that employed in its two South African funds.

"We typically would take an industrial player alongside us into other African markets, in addition to joining forces with local partners; so this is a slightly different angle to investing, compared with our approach in South Africa. For example, when we invested in a pharmaceutical manufacturer in Uganda, we partnered with Cipla, an Indian pharmaceutical manufacturer, as well as a local partner with management skills, strong local relationships and an ability to identify local talent."

African Infrastructure Investment Managers (AIIM) is further along

Dick Merks

From the media archives:

Investing In Africa: The Abraaj Story

12 MAY 2014

The Abraaj Group has invested \$2.2billion in Africa to date. And they are just getting started.

Abraaj's strong presence in sub-Saharan Africa is in large part a result of its 2011 merger with Aureos Capital, though the Abraaj Group's partners are keen to stress a seamless integration and complementarities across the continent (Abraaj having been active in North Africa).

Aureos Capital, the \$1.3-billion dollar fund run by Sev Vettivetpillai, was initially established in 2001 as a joint venture between the Norwegian government's PE arm, Norfund, and the Commonwealth Development Corporation (CDC). In 2008, Vettivetpillai and the principals of Aureos led a management buyout of the firm from its parent entities to form an independent PE fund with a strong sub-Saharan Africa practice.

Source: Ventures-Africa.com

Chad Smart

SIDEBAR

Maintaining various regional offices has its challenges, from a staff- and communication-management perspective. AIIM, which has offices in Cape Town, Nairobi and Lagos, says its team members have a disciplined focus on "keeping people talking, to ensure there is no sense of isolation and to make sure that all areas of the business remain aligned".

the continuum of carrying out and managing multi-country African deals. Jurie Swart, AIIM CEO, describes the transition that AIIM's funds have made, saying, "one of the biggest changes that we experienced over the years has been a move from being a South African-focused manager to becoming pan-African, and in seeing the development of a deal-flow pipeline that increasingly has a broader African focus".

Jurie Swart

He explains that the success of this transition in fund mandates was underpinned through South Africa serving as "an incubator for us to develop our skills and methodologies for private equity infrastructure investing".

Like many of his peers, Swart emphasises the importance of establishing a regional presence and of having people on the ground with a proper understanding of the region from a deal origination, structuring and management perspective.

Khanna supports this view – and notes the rewards thereof. "What we've seen is that managers who have taken the time to either set up an on-the-ground presence or who have developed a strong network in the countries and have done deals, have gone on to make exceptional returns."

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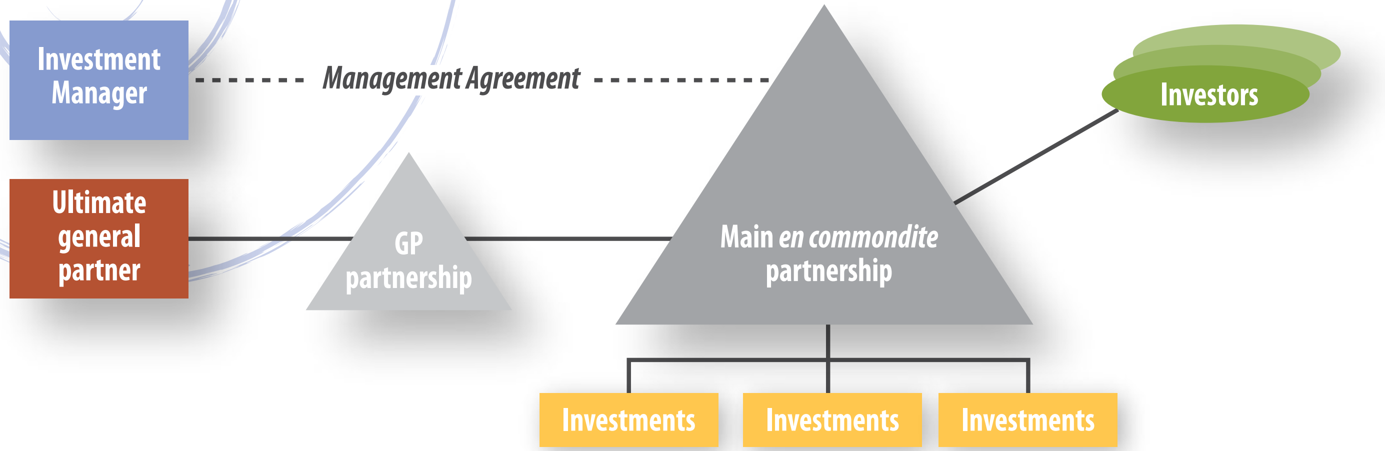
good thinking

Structured for success:
South African partnership structures for private equity funds



Overview

Private equity funds are typically structured as *en commandite* partnerships. The key entities are the *en commandite* partnership itself (governed by a partnership agreement), the general partner (responsible for the day-to-day management, makes final investment decisions, has unlimited liability for the debts of the partnership and is typically structured as a separate *en commandite* partnership for the management team to share in the carried interest), and the investment manager (sources investments, makes recommendations to the general partner and provides administration services).

Key terms / features of the partnership agreement

The key principal terms include fixed life (i.e. 10 years), fixed investment period (i.e. 5 years), unfunded commitments which are drawn down when required, management fee (i.e. 2%), preferred return (minimum return to investors of 8 to 12%), carried interest (20% after payment of the preferred return), distribution of proceeds when investments are realised, restricted transferability of interests (consent of the general partner is required), a pre-determined investment policy, and the power for investors to remove the general partner ("for cause" or "without cause" if compensation is paid).

Why they are used as investment vehicles for private equity

Partnerships have the benefit of being tax efficient and, as they are tax transparent vehicles, investors will be taxed as if they own the underlying assets directly. They also provide investors with limited liability (up to the amount of their capital contributions) provided they do not become involved in the management of the partnership.

Alternatives to partnerships

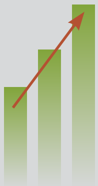
Alternative vehicles include trusts or company structures. Trusts can be complex, they require the trust deed to be lodged with the Master of the High Court and letters of authority to be issued before the trustee can act, and are also generally unfamiliar to international private equity investors. Companies have the benefit of limited liability for investors, but have an additional level of taxation. Partnerships are therefore the preferred structure.

Source: Ross Manton - Associate Director (Qualified in England & Wales) at Webber Wentzel

A force for good

From the SAVCA archives:

Over the three-year period from 2005/6 to 2008/9, private equity backed companies in South Africa have achieved:



- Annual world-wide employment growth rates of 9%, compared with JSE listed business's growth rates of 4% and 8% recorded for private equity backed businesses in the UK.
- Employment of 5% of South Africa formal sector employees which equates to around 427 000 jobs.
- Average domestic employment growth rates of 10% per annum, compared with 1% across all businesses in South Africa and 4% for UK private equity backed businesses.
- Average turnover growth of 20%, compared to 18% for JSE businesses and 8% for UK private equity backed businesses.
- Pre-tax profit growth of 16% per annum compared to 14% for JSE businesses and 11% for UK private equity backed businesses.
- Growth in exports of 31% per annum, on average compared with 24% nationally and 10% for UK private equity backed businesses.
- Average R&D expenditure growth of 7% compared to 1% for JSE listed business.

Extract from the SAVCA-DBSA Economic Impact Study 2009

South African private equity has become a mature and highly respected industry. "It is a dynamic environment in which entrepreneurs, equity and money can meet and align their interests in order to create value," says Ethos Private Equity CEO André Roux.

"Private equity has made, and continues to make, a positive contribution to the economy. It facilitates the more efficient allocation of capital, directing investment to the right kind of businesses. It has given companies which do not fit into the large corporate structures a new lease of life and direction that they would have not got in the context of their current ownership."

Roux says private equity is not just about comparing portfolio company performance with the equivalent public market returns. "It is far more than this. Private equity does better business all round and undoubtedly has a higher purpose. It is an agent and catalyst for expansion and development. It is a source of ideas and capital for managers to bring about growth in their businesses. It is about employment creation, expanding economies, and business sustainability."

From the SAVCA archives:

What the portfolio companies say:

Preference for private equity

Almost half of those questioned state that private equity is preferable to other forms of equity funding. The most commonly cited reason for this is the strength and equality of the partnership between investee and investor, underlining the importance private equity investors place on the correct alignment of interests.

Dynamism and innovation

Exactly three quarters of the survey's respondents reported that their businesses introduced new products or services following the private equity investment. The new capital is also instrumental in funding the purchase of new technology or machinery.

Major growth driver

Over half (56%) of responding investee companies said private equity financing allowed the business to grow faster. The survey showed that the average proportion of total sales growth over the last two years among a sub-sample of investee companies questioned was 49%.

The fastest-growing 20 respondents saw their EBITDA increase by more than 130% over the same period.

In addition to underpinning acquisitive growth strategies, private equity firms use their operational and strategic capabilities to help investee companies to generate significant organic growth following investment. Their deep and wide networks of contacts are singled out as being critical to this.

Job creation

The findings of the survey show that investee companies create employment, with the number of staff employed by respondents both within and outside South Africa growing by around 40% over the two-year period covered.

Lasting strength

Private equity investors play an invaluable role in helping their investee companies build more robust, sophisticated structures. According to the survey, no fewer than 70% of responding companies mentioned corporate governance as a key private equity contribution. The financial acumen private equity investors bring to the table is also rated as a major contribution.

Extract from the SAVCA-DBSA Economic Impact Study 2013

A seasoned South African LP

SAVCA: ***Why has the EPPF been such a committed private equity investor for so many years?***

SL: If you look at the history of private equity, over a ten-year horizon or even more, it has consistently outperformed other asset classes. We at EPPF believe that we need exposure to this asset class to diversify our exposure whilst maximising our returns for members. I imagine that there must have been some robust debate back in 1995 when we started investing in private equity. Obviously, there is always prudence, concern and a rigorous process before any new direction is approved. However, today there is definitely full buy-in and support from the trustees because they now have a better understanding of the benefits of investing in private equity in terms of returns and diversification.

SAVCA: ***How has your allocation to private equity changed since the EPPF began investing in the asset class?***

SL: We started out with a very small allocation and have increased this gradually over the years. This allocation was somewhat constrained by Regulation 28 restrictions, which initially meant that we could invest only 2.5% of our assets into alternative assets including private equity. This meant that many other options were competing against private equity within the 2.5% allocation.

SAVCA: ***What did the changes to Regulation 28 in 2011 mean for your investment strategy?***

SL: The changes meant that we had the latitude to increase our allocation to South African private equity while also expanding our investments into private equity funds which target African growth beyond South Africa. Currently we have allocated 2.5% of our total assets to domestic private equity and an additional 2% of our total assets have been allocated specifically to private equity in Africa (ex-South Africa). This is a significant amount and will allow us to capitalise on opportunities in Africa. There are many small to medium-sized enterprises, including family-owned businesses, which need a capital injection to grow and corporatise. We strongly believe that these investments will also help develop a listings pipeline in various African markets. So these changes to Regulation 28 have been positive for private equity, and, in the longer term, also for listed equity in Africa.

SAVCA: ***What sectors have shown good returns and what are your expectations for returns?***

SL: I cannot specifically single out any particular sector which has really outperformed. We have invested with private equity firms who have invested across many different sectors and have managed to extract value overall. It really depends on the timing of specific investments, structuring of the particular transaction as well as on the investment team. In many cases one firm will succeed in a particular sector, while another disappoints in the same sector. Expectations will vary based on the investment philosophy and strategy, but, given the long-term nature of private equity, we expect returns, on an internal rate of return basis, in the region of 25% to 30% or two and a half times money as a general norm. Expectations will differ for private equity real estate, infrastructure or mezzanine structures.

SAVCA: ***What impact did the global financial crisis have on your private equity investments?***

SL: It all comes back to timing and the spread of your investments: If you got in at the right time, the global financial crisis may not have had much of an impact, especially, given the fact that private equity investments are of a long-term nature. For us as EPPF there was a balance; we had funds into which we had invested at the right time, there were those that we entered at the wrong time and were slightly affected by the global crisis.

SAVCA: ***What are your views on co-investment opportunities?***

SL: This has been a practice which has gained popularity in the past few years and it is something that we have recently started focusing on. As co-investments help to enhance returns we are definitely insisting we be allowed an opportunity to co-invest whenever we invest in a fund. We will not co-invest in every transaction, but we will get involved where we think we can add value and enhance our returns. We tend to approach co-investment opportunities with a fair degree of flexibility; we currently have not set rigid percentages and absolute limits.

Q&A with Sbu Luthuli, CEO: Eskom Pension and Provident Fund

The Eskom Pension and Provident Fund (EPPF) boasts an almost twenty-year track record of investing with South African private equity fund managers. SAVCA speaks to Sbu Luthuli, chief executive at EPPF, about his views on the private equity asset class and how the industry – as well as the EPPF's approach to it – has evolved over the years.

Sbu Luthuli

A new voice for institutional investors

From the archives:

ILPA PRIVATE EQUITY PRINCIPLES

The Institutional Limited Partners Association ("ILPA") released the Private Equity Principles (the "Principles") in September 2009 to encourage discussion between Limited Partners ("LPs") and General Partners ("GPs") regarding fund partnerships. These Principles were developed with the goal of improving the private equity industry for the long-term benefit of all its participants by outlining a number of key principles to further partnership between LPs and GPs. Over the past year, ILPA has heard numerous success stories regarding improved communication between LPs and GPs. To that end, the Principles are off to a great start in achieving the goals that were originally envisioned.

In order to make ongoing improvements to the Principles, ILPA committed to solicit additional feedback from both the LP and GP communities throughout 2010. After reflecting on the extensive input from these discussions, the ILPA Best Practices Committee drafted a new version of the Principles. This release retains the key tenets of the first Principles release while increasing their focus, clarity and practicality.

We continue to believe three guiding principles form the essence of an effective private equity partnership:

1. Alignment of Interest
2. Governance
3. Transparency

Source: Institutional Limited Partners Association: Private Equity Principles; Version 2.0, January 2011

Seasoned institutional investors into private equity – South African as well as those based in offshore markets – have over time adapted and refined their approach to managing relationships with private equity fund managers. The trend towards a greater assertiveness by limited partners (LPs) with respect to the terms of their agreements with general partners (GPs) is likely to continue.

These shifting relationships between investors and fund managers is one of the most notable changes that the industry has seen globally over the past few decades. Sandeep Khanna, a managing director at The Abraaj Group, observes that, "having operated in these markets for over two decades, we've seen a near constant pendulum swing backwards and forwards in terms of the relationship between LPs and GPs".

Khanna's view is that this working relationship is far closer today than it was in the earlier days of private equity.

"What we are seeing more of today than ever before is far closer collaboration between LPs and GPs. Historically, the relationship has been very much one of LPs simply providing capital to their GPs – and that was the end of it. Today you are seeing LPs co-investing alongside their GPs on a more regular basis, bringing potential deals to their GPs and providing useful insights where appropriate. All of this was unheard of ten years ago," he says.

In addition to the relationship having become increasingly collaborative, there is also a distinct move towards LPs winning more favourable terms in partnership agreements – in large part owing to the step-change brought by the global financial crisis, particularly in moving asset owners to re-evaluate their approach to allocating capital.

Aligning interests

For instance, the publication by the Institutional Limited Partners Association (ILPA) in 2009 of the Private Equity Principles was a result of investors reassessing the terms of investments and the relative risk and reward of making such allocations. LPs used these principles as a tool to establish global benchmarks and standards for private equity investing, with a particular emphasis on better aligning the interest of GPs and LPs.

Cindy Valentine, a partner at King & Wood Mallesons, observes that since 2008, with the scarcity of available capital and the advent of the ILPA Principles, international LPs in international funds gained substantially more favourable terms compared with the era before 2008.

"Although the first version of the ILPA Principles caused tension as GPs saw it as a serious departure from market standards, the more balanced revised Principles, published in 2011, was better received: Even if GPs did not always concur with the detailed terms of these principles, they nevertheless agreed with the appropriateness of the three main focus topics stipulated, namely alignment of interest, fund governance and transparency."

She explains that the story of the relationship between LPs and GPs is slightly more nuanced for African private equity funds, owing to the types of investors active on the continent.

DFIs set the tone in Africa

"Although ILPA has influenced the market, historically and currently the terms of African-focused funds tend to be set by development finance institutions (DFIs) who generally provide a substantial amount of capital, particularly for early-stage emerging market private equity funds. Many other investors, such as pension funds, family offices or other institutional investors, follow the lead of the DFIs, providing relatively light input on fund terms," Valentine says.

She explains that, where DFIs are admitted into a fund, which is ordinarily on a first close, the DFIs will review and substantially negotiate the terms. The outcome of the negotiation is dependent on, amongst other things, the extent of DFI capital relative to the fund target, the experience and success of past investments made by the private equity team and the internal requirements of the DFIs.

Valentine explains that an important factor in aligning the interests of GPs and LPs is the GP commitment, which has become the subject of increasing scrutiny. "Although the degree of required GP commitment varies from fund to fund, with there for example being a distinction between the investor requirements for a large institution and a smaller first-time fund, the market standard is in the region of 1% to 2% of the fund commitments."

Further, she points out that LPs are looking closely at exclusivity restrictions and conflicts of interest, to ensure that GPs' interests are aligned with those of the LP. LPs – and DFIs in particular – are also growing increasingly firm about co-investment rights, with some investors making their investment commitment into a fund conditional on such co-investment rights.

The approach to the economics of funds has also shifted over the years, Valentine says. There is continuous pressure on management fees, and while transaction fees in the past may have been shared fifty-fifty or eighty-twenty between the GP and LP, transaction fees are now one hundred per cent set off against the management fee paid to the GP.

"There is also greater scrutiny of fund costs, establishment costs, placement agents' fees and abort costs."

Cindy Valentine,

Downside protection

Enhanced downside protection for LPs is a further area of concern for LPs, finding expression in, amongst others, elements such as key-man clauses, with LPs pushing for automatic suspension or termination of the investment period should a so-called key-man event occur without rectification.

> *Investors now require detailed drawdown notices, extensive bespoke reporting requirements and heightened notification requirements from GPs, all of which place a significant administrative burden on the GP.*
>
> Cindy Valentine

There is considerable drive to heightened transparency, too. "Investors now require detailed drawdown notices, extensive bespoke reporting requirements and heightened notification requirements from GPs, all of which place a significant administrative burden on the GP. Further, advisory board disclosure and rights have become increasingly important." Particular to African-focused funds is the importance of environmental, social and governance criteria which differ between investors and also include extensive reporting, notification requirements and associated rights for the LP should the GP breach such requirements.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Still banking on private equity

Q&A with Clive Howell, head of Nedbank Capital Private Equity

SAVCA speaks to Clive Howell, head of Nedbank Capital Private Equity, about Nedbank's continued focus on private equity activities despite the regulatory conditions that have lessened other banking institutions' appetite for this asset class. The bank currently has a private equity book of R1.3bn and is looking to expand this portfolio further.

SAVCA: ***Many local and international banks responded to regulations such as Basel II and III by closing their private equity divisions. What has Nedbank's response been to this, in its captive private equity model?***

CH: These regulations had a major impact on banks, and Nedbank is no exception. With every version of Basel, the capital that banks have needed to hold has increased; in the case of private equity this has increased almost fourfold. That means that the attractiveness of private equity at the margin becomes a little bit debatable.

As a team we're targeting IRR returns of 25% to 30% or more; even on a fully risk-adjusted basis we're coming in at acceptable, positive numbers. And so, from our bank's point of view, private equity is an important source of non-interest revenue. At the end of the day it comes down to what sort of returns you are generating relative to the capital that you hold. So, in Nedbank's case, we've done the numbers and are firmly continuing down the road of investing in private equity.

SAVCA: ***How have you seen the South African private equity market develop over the years, especially in the mid-market space in which you operate?***

CH: Reflecting on that, our client base is really family-owned businesses, in the lower mid-market space. Perhaps one of the most important developments we've seen is an increased understanding and awareness of private equity in this segment, which had made our job easier. Our ethos from the get go was, how do we partner with these businesses to bring structure and governance to facilitate the growth that they are aiming for. The challenge in the early days was that you had to educate your client that this is what was normal for a transaction; trust took a great deal longer to engineer.

It's still very important for us, there must be chemistry and trust, otherwise we don't even progress. Now, because of the increased awareness of private equity as an asset class and the fact that there are many small one- or two-person boutique corporate finance houses that make a living out of advising even the small family-owned businesses, the robustness of that market has improved dramatically over the years.

SAVCA: ***What are the big themes that you've observed in the private equity industry over the years?***

CH: We've seen various trends over the years. Private equity must have probably got its biggest kicker in the 1980s, with the disinvestment drive. There was the Y2K hype and the IT boom, which generated a whole raft of deals. The implementation of BEE resulted in a massive wave of deals, and a secondary BEE wave of late. Those are the sorts of macro themes that have influenced the nature of opportunities.

There was also what I would call the false start of infrastructure investing; many investors were positioning for businesses allied to or supplying into what they were hoping was going to be a substantial infrastructure boom, which really turned out to be stop-start in nature and less than successful from a private equity point of view.

So, there's been a couple of these themes, but, at the end of the day I think, for pure private equity, it's often focused on consumer-facing businesses or businesses that can get from EBITDA to cash fairly quickly and are more predictable types of businesses, that are the perennial favourites.

SAVCA: ***Another change in the local industry has been the increasing drive to gain exposure to African regional growth. What is the bank's view on this?***

CH: It is something that, over the past eighteen months, has really begun to get our attention. So far, the way in which we have tapped into African investments outside South Africa has been through our existing portfolio businesses in South Africa. But, in terms of exposure, these investments are still being limited largely to Namibia, Botswana, the DRC, Zambia and Mozambique.

We're in the process of developing a comprehensive African private equity strategy in line with the bank's broader African ambitions and have been given the license to consider direct African deals. We are very circumspect about potential deals, though, and are clear that our model is partner-based and that we don't take majority stakes. A trusted local partner and shareholder are key to our business in Africa.

Clive Howell

A brief history of the use of debt in South African private equity

From the archives:

A comparison of DEBT MULTIPLES

When looking at debt multiples only, it is clear that much lower levels of debt are used across all deal sizes in Africa, with the largest deals averaging only 3.12x. While there is certainly an upward trend in debt use as deals become larger, the rate of increase is far lower than that in global deals. Even deals involving companies with Enterprise Values of over USD 250 million are only 35% debt-financed compared to the global average of 61%.

This is due to a number of factors including poor access to debt markets in parts of the continent, the relative risk aversion of South African banks and generally high interest rates across the continent. The average debt use includes a number of deals that do not utilise any debt in the capital structure. When these all-equity deals are excluded from the data set, the Debt/EBITDA ratio moves up to approximately 2.8x. This is consistent with the levels at which South African banks say they will provide debt to deals.

Source: The RIsCura Bright Africa Report, 2014

Lourens Campher

The use of debt in South African private equity transactions remains relatively low by developed-market standards, averaging around three times EBITDA (earnings before interest, tax, depreciation and amortisation) for large transactions, and with mid-market and smaller transactions typically seeing far more conservative use of debt – or none at all.

Industry archives show that the use of gearing in the early days of the industry was lower than is the norm today, with deals at the larger end of the spectrum structured with debt multiples of around one to two times EBITDA.

Halcyon days

Leverage edged up over time, notably during the five years or so leading up to the global financial crisis. "Debt-to-equity ratios were, in general, far more prudent and conservative in the earlier days of private equity, when EBITDA multiples for big, bank-funded deals were probably around one times. It was only after 2003 that they began to rise to three-and-a-half times to five or even six times," says Dave Stadler, CEO of Paean Private Equity. "Banks became far more bullish on private equity deals when they saw the early successes."

Many of the large pre-crisis deals were being financed through Eurobonds, and the traditional profile of senior debt was changing notably. "Historically, the repayment profile of senior debt had been over five years," says Stadler. "Lenders now started to push this out to seven years. Or they would structure the financing so that only interest was repayable during the term, with bullet payments made much further down the line. This generous deal structuring was being led by foreigners – and money had become far easier to access."

The impact of the 2008 financial crisis was to stem the gearing trend in South African private equity. Banks hunkered down and slashed their preferred gearing ratios to two or two-and-a-half times EBITDA – a benchmark which has remained more or less intact since then, and which is well below norms in developed markets.

As Richard Flett, managing director of Horizon Equity, puts it, "the halcyon days of debt-to-EBITDA ratios of five times or more last seen in 2006-7 are long gone and won't be back without a substantial reduction in interest rates, if ever".

Bankers' approach to debt

Lourens Campher, head of Specialised Growth Finance at Investec Corporate and Institutional Banking, adds that banks' approach to funding has become far more focused on the ability of the underlying business to service and repay debt – and that EBITDA is not the best indicator of a company's debt capacity. He adds: "If you aren't working with and measuring sustainable cash flow – the cash available after factoring in capital expenditure and the working capital cycle – you could burn your fingers."

Campher explains that, "depending on the ability of the business being funded to convert EBITDA into cash, debt-to-equity ratios typically are around fifty-fifty today, moving up to sixty-forty in instances of businesses with a healthy capacity to service debt." This compares with proportions of debt-to-equity of up to eighty-twenty seen during the immediate pre-crisis years or, in terms of EBITDA multiples, as high as five times.

Looking back even further in time, Campher notes that typical deal structuring in the early 1990s was almost all in the form of debt. "When I started my career, the banks providing funding were doing management buyouts purely with debt funding, with no or very little equity. This only started changing when Standard Merchant Bank and FirstCorp began redefining the approach to funding by taking equity upside in deals or by requiring material equity cheques alongside their debt."

He observes a far more cautious approach amongst bankers today. "The senior funders of private equity deals now are much more conservative and, depending on the security package, any exposure of more than four times free cash flow starts falling into a stretched senior or mezzanine bucket."

Shareholder loans as a returns kicker

In addition to the use of senior debt in deal structures, private equity funds in the past would also employ shareholder loans alongside their investment in shares. This trend continues today. Flett explains, "These loans are really quasi-equity with little in the way of security or covenants, since the fund would protect itself through the shareholders' agreement instead. By way of example, in a business valued at four times EBITDA in the "old days", the total investment by the private equity fund including shareholder loans might represent three times EBITDA, with bank debt at one times EBITDA."

Flett goes on to say that the use of shareholder loans has always been a popular structure in South Africa, and a useful tool to support equity performance. "It was – and still is – a useful tool for the private equity fund to get a substantial part of its total investment back ahead of the other shareholders, improving its total return and the internal rate of return, but also protecting the fund's downside in a liquidation. First-world private equity funds often use preference shares to fulfil a similar role, but they can be fiddly and present tax disadvantages, at least in South Africa. The shareholder loan has always been more popular here."

> *The senior funders of private equity deals now are much more conservative.*
>
> *Lourens Campher*

On the use of EBITDA

Earnings before interest, taxes, depreciation and amortization (EBITDA) is useful for comparing the income of companies with different capital structures. Companies with significant fixed assets, such as manufacturing companies, or companies which incur large depreciation charges or companies which have significant intangible assets which result in large amortization charges can easily be compared. It is also a useful measure for a company's creditors as it shows the income available for interest payments.

Source: Reuters Financial Glossary

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Aligned interests

Anthony Hewat

The traditional private equity remuneration structure – that of a 2% annual fee together with a 20% share in profits beyond a hurdle rate – has been a steady feature of the global industry for decades.

Anthony Hewat, a founder and director at Metier, says the incentive model in private equity funds appeals to those who want to be independent and enjoy a non-corporate environment with flat structures and no head office politics, and no layers of middle management or red tape. "In fact, we see people who take pay cuts in order to join this industry. They prefer a model which directly incentivises them to perform."

He argues that, compared with typical corporate financial structures, being part of private equity fund model means being plugged into a far more profit-focused model, with a longer horizon and greater uncertainty.

"Profit share comes at the very end of the transaction, and you only make your money after your investors have," says Hewat. "This means that the interests of the fund manager, the institutional investor and the portfolio-company management are all fully aligned. What's more, the requirement of material co-investment by the team members ensures alignment especially in the case of lower-returning funds, so that the alignment on the downside and not just the upside is ensured."

Hewat describes the private equity remuneration model as the most brutal incentive scheme in all of business – but also a particularly well-defined and simple one. "It is hugely formulaic and very clear. Profits get allocated amongst team members, and no one else. Remuneration committees or boards do not decide on your rewards. There is complete freedom and opportunity to make money, even if perhaps you don't."

FUND SNAPSHOT

RMB Corvest

Corporate Leveraged Investments (Corvest for short) was established in 1989 by Neil Page, Dick Merks and David Rissik. RMB bought a 49% shareholding in 1992. The name was changed to RMB Corvest in 1994 when RMB acquired a majority stake.

Most significant investment:
We invested in Fidelity Group in 1990, when they were doing only R150m turnover. Through organic growth and acquisitions we grew this to several billion in the early 2000s. We then unbundled it into three separate businesses and brought in BEE and strategic partners. Today we are still involved directly as well as indirectly through BEE structures in G4S and Fidelity Security. We have created liquidity events numerous times for ourselves and our management partners over the twenty-five years we have been involved. As an on-balance sheet private equity firm, we have no restrictions on reinvesting in existing deals and this has enabled us to create partial exits and reinvestments.

Mandate in the early years, and how this has changed over the years:
RMB Corvest's mandate has grown from maximum R5m per investment to the current R500m per investment. RMB Corvest currently manages in excess of 60 investments with funds under management of over R9bn.

The FirstRand group's contribution to South African private equity

"The FirstRand Group has been the number one contributor to the growth and sustainability of private equity in South Africa," says Cora Fernandez, head of Sanlam Investments, and a former CEO of Sanlam Private Equity.

The group certainly has an impressive track record. RMB, which was one of the three entities that merged in 1998 to form FirstRand, was founded in 1977 by GT Ferreira, Laurie Dippenaar and Paul Harris. It began as a structured-finance house and sparked some of the entrepreneurial flair – and the capital clout – that would boost the evolution of private equity in the country.

It started RMB Ventures as well as acquiring a majority stake in RMB Corvest, was an anchor investor for all three of the Kagiso private equity funds, had a 49% shareholding in Ethos Fund I, and was an anchor investor in the Tiso private equity fund.


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Mezzanine funding finds is place

Mezzanine finance: A definition

Debt which ranks behind senior secured debt but ahead of trade credit and shareholders' funds in terms of security. Mezzanine debt is often used in higher leveraged transactions to maximise funding availability from a company's own balance sheet. It may provide for equity-like features such as attached share purchase warrants or participation in cash flow.

Source: SAVCA-KPMG Private Equity Industry Survey, June 2014, Page 67

Colin Rezek

Mezzanine-type funding structures were the norm in the early years of South African private equity. It was only in the past decade or so, though, that it has become a recognised category within private equity.

"It is a very interesting and flexible piece of the private equity market," says Colin Rezek, co-founder of Vantage Capital, the largest independent mezzanine provider in Africa, with R3bn under management.

Rezek describes how his firm came to move into mezzanine. "When setting up our early private equity technology fund, which closed in 2001, we spoke to many investors, including our pledge funder, the Dutch development finance institution FMO. The FMO suggested we take a look at the mezzanine model which was starting to gain traction in South Africa at that time, driven by a decline in market interest rates. The FMO was particularly interested in tracking the development of this funding form in South Africa."

From the media archives:

Mezzanine financing is the new kid on the block

BY THOMAS SCHWARTZ
19 September 2006

The emergence of independent mezzanine funds in South Africa has provided not only a new opportunity for business to access capital but also an investment opportunity for fund managers.

This new asset class has only recently become viable in South Africa, as previously it had been crowded out by high interest rates and high inflation rates, leaving only senior bank debt and private equity finance as the two major asset classes.

The sound macroeconomic policy of the government and monetary authorities, which has been so conspicuously successful in reducing interest and inflation rates, has now opened the door for this asset class.

With senior debt sourced at rates typically below 10 percent and equity funds targeting returns of 30 percent, the space for funders seeking to earn returns between 15 percent and 20 percent has ballooned.

As the name suggests, mezzanine finance fits in between senior, or bank, debt and private equity finance.

Its returns are higher than senior debt but lower than the returns demanded from a private equity fund.

Source: Business Report archived on iol.co.za

With buy-in from four development finance institutions, Vantage began fundraising in an optimistic market environment characterised by abundant liquidity. "Over a period of two to three years we raised R1bn for our first mezzanine fund, which closed in October 2006. The fund incorporated stretch senior debt and a small equity kicker."

Since then, the nature of the mezzanine opportunity has altered in the South African market.

Rezek explains that, because private equity return targets have edged lower since the global financial crisis – now at IRRs of around 25% – private equity deals are not as reliant as before on the returns boost of a mezzanine slice. What's more, there have been only a few major buyouts since the financial crisis.

"We have shifted our focus instead to the untapped mid-market space. Here entrepreneurs seeking funding are having to deal with banks, whose conservative approach focuses on the traditional tangible asset base of the business, and on what sureties are available to limit risk. Mezzanine finance, by contrast, has a far more creative approach to the funding structure and therefore offers different solutions."

The South African mezzanine segment has declined in size since the crisis. "It is now a far less competitive environment, especially with Makalani being delisted, and Mezzanine Partners being bought by Stanlib and incorporated into a larger credit fund."

Vantage Capital closed its second mezzanine fund in 2012, with around a third of this R1.85bn fund targeted for African markets outside South Africa. It is raising a third fund.

A future for fund of funds

Fund-of-private-equity-funds structures offer institutional investors who have limited private equity experience, or who have moderate amounts of available capital, the option of easy entry and suitable diversification. South African private equity has a healthy history of fund-of-funds products, including those from pioneers Momentum, Old Mutual and Sanlam. Others now offering fund-of-funds access to private equity include Ke Nako, South Suez and Ashburton.

According to Paul Boynton, CEO of Old Mutual Alternative Investments, adequate diversification is the key element of a successful fund of funds. This incorporates diversification across a suitable spread of underlying private equity funds that are managed by a variety of fund managers, and exposure to a range of vintages – referring to the year in which the underlying fund is closed.

Boynton, whose team closed its first fund of funds in 2006, says that take up of the South African fund-of-fund offering is more realistically described as a consistent progression, rather than one of rapid growth. "Investors are certainly more interested in private equity these days, especially since the implementation of favourable changes to Regulation 28, and with investors seeking to diversify away from expensive listed markets. We are increasingly speaking to intermediaries and sophisticated investors about this asset class."

Jake Archer, investment professional at Ashburton Investments, observes that the relatively attractive returns from the listed equity market have negated the incentive for investors to diversify into alternative asset classes such as private equity.

"Over the past several years, returns in the listed equity market have been rewarding, so investors have not been particularly compelled to diversify. The fund-of-funds sector has been a slow-moving process but we are definitely seeing some traction."

Archer explains that the large South African pension funds have the capacity and talent to run their own in-house fund-of-funds capabilities, which includes manager selection and oversight. It is the smaller institutional investors, particularly those with assets in the smaller to mid-size range, which are considering external fund-of-funds investments. "These investors are keenly exploring fund-of-funds opportunities through their asset consultants, who have been actively marketing this theme for quite a few years now."

Paul Boynton

Jake Archer

From the media archives:

South African private equity fund of funds manager FirstRand Investment Management (FRAIM) is raising capital for its second private equity fund of funds

15 October 2009

IT IS questionable if the Treasury's suspending of section 45 of the Income Tax Act will pass constitutional muster.

After capital gains tax was introduced in 2001, the government announced revised group relief measures for companies. Section 45 was intended to facilitate transfers among companies that constituted a group, whether such transfer took place by way of an exchange of shares, debt or cash, or as a dividend.

The manner of the suspension of the section early this month –without prior notice to taxpayers and other interested stakeholders – is draconian and undermines the rule of law in so far as SA's tax system is concerned, tax analysts say. "The suspension placed on section 45 undermines the relationship between taxpayers and the government. The government does not trust taxpayers and tax practitioners," says Beric Croome, a tax executive at corporate law advisers Edward Nathan Sonnenbergs.

Source: Prequin.com

What a difference a few decades make

FUND SNAPSHOT

AIIM

African Infrastructure Investment Managers was established in 2000 as a joint venture between Old Mutual Investment Group and Macquarie Group.

First fund closed in 1996:
AIIM took over the management of AIF in 2000. Investors in SAIF include major South African institutional investors such as Standard Bank, Old Mutual, Futuregrowth, Liberty Life Assurance Company, Metropolitan Life, Public Investment Commissioners and Transnet Pension Fund. The African Development Bank is the only non-South African investor.

Most significant investment:
Our flagship pan-African fund, AIIF2, has made commitments to projects in Southern, East and West Africa. The recently concluded Azura power project, a 450MW open-cycle gas turbine power plant in Edo State in Nigeria, is among the most significant investments for our business.

The Azura IPP is the pioneering greenfield IPP in Nigeria. This project is not only critical to the country's strategic generation mix, but in addition will be used as a template for future IPPs following the root and branch restructuring of the country's power industry. This investment has been vital to demonstrate the required participation of private funders from an early stage to work together with government and multilaterals to develop a structure that is able to serve the interests of all stakeholders.

Biggest changes since those early years:
One of the biggest changes for AIIM is the move from being a South African-focused manager to being truly pan-African. Some of the changes that we've seen in the industry more broadly is the shifting investor base from being dominated by banks to pension funds becoming more comfortable with the return profile of private equity investments.

Observations on some of the major changes in South African private equity over its thirty-year existence (as told by seasoned practitioners and observers)

- The industry has progressed from manually intensive spreadsheets and small-business software, to advanced systems – although Excel is still used widely. The big managers tend to use sophisticated new accounting and reporting systems established and proven in the US, UK and Europe. Most of the mid-size to large fund managers have extensive back offices.
- In the old days the results of portfolio companies would be faxed through to GPs. Reporting systems now are automated and integrated.
- Deals today entail far more complexity. The new Companies Act has created serious considerations, BEE is an important factor, competition regulation must be factored in, tax legislation keeps transactors on their toes – and deal due diligence has become an crucial and costly element.
- Other changes in the industry include greater deal cooperation among participants. "In the old days a single fund would do the entire deal from start to finish," says RMB Corvest's Neil Page. "Now we see greater use of partnerships as funds seek out like-minded players, in their size tier, or across tiers, depending on the deal."
- John Bellew, a partner at Webber Wentzel, describes the industry today as being significantly more contested. "Until around 2003 or 2004, the industry was dominated by Ethos and Brait, with little competition. It follows that deal sourcing then was easier and pricing less competitive. By contrast, the industry is far more competitive today, which must have an impact on returns.
- Jurie Swart, CEO of African Infrastructure Investment Managers (AIIM), observes that the years have brought about a changed investor base. "In the early days, private equity fund investing was dominated by the banks. However this participation has decreased due to regulatory capital requirements. A positive trend is that pension fund investors have increasingly become more comfortable with the risk-return profiles and long-term nature of private equity investments. And we have also seen the emergence of the DFIs as a very active investor group."
- A notable change over the years has been the growing willingness amongst South African banks to provide debt finance in private equity deals, together with the degree to which banks have been able to create very sophisticated debt products that balance risk and return, according to Ethos Private Equity's André Roux. "In short, I would say that the South African banking system has been able to keep pace with the private equity industry, to meet the needs of this class of investor."

John Bellew

In the process of preparing this publication...

43 people were interviewed across **30** firms

13 hours of interviews were recorded via conference call

8 notebooks were filled

The project team dealt with people in at least **9** different cities, in **4** countries

15 cups of coffee were offered and accepted during interviews

4 versions of the cover design were prepared

A first draft of more than **24 000** words was prepared; nearly $\frac{1}{3}$ of this was removed in the editing process. Thereafter the document took on a life of its own, with the final proof reaching 24 000 words.

The project team devoted more than **350** hours on the project in the **76** days between the first project meeting until the day it was sent to the printer

Trivia

1. An uncut diamond – and also the name of a South African private equity firm founded in the early 2000s
2. The famous speech made by a South African politician in 1985 that strengthened the international will to impose economic sanctions on South Africa
3. The independent private equity fund manager formed when Barclays Africa sold its South African private equity book
4. The name of the emerging market private equity firm which was spun out of the CDC Group
5. The initials of the association which released the Private Equity Principles in September 2009 to encourage greater discussion between Limited Partners and General Partners regarding partnership agreements
6. The surname of SAVCA's first full-time CEO, appointed in 2006
7. The section of the Pension Funds Act that was changed in 2011, allowing South African pension funds to invest up to 10% of their portfolios in private equity
8. The South African pension fund which first started investing in private equity in 1995
9. The state-owned organisation which seeded venture capital technology funds in the early 2000s
10. The French DFI which began investing in African private equity in the nineties
11. The name of the firm established in 2010 to continue the active management of the Here Be Dragons' South African portfolio of investments
12. The firm which originated as the private equity division of First National Bank
13. The name of the private equity fund manager, taken from French, and which means "an area of activity in which one excels"
14. Switzerland's third most populous city – and the name used for international banking regulation that has spurred banks to limit their private equity activities
15. The earnings measure typically used in private equity
16. The surname of SAVCA's founding chairman

1. Brait 2. Rubicon 3. Rockwood 4. Actis 5. ILPA 6. Fourie 7. Regulation 28 8. EPPF 9. Industrial Development Corporation 10. Proparco 11. Knife Capital 12. Ethos 13. Metier 14. Basel 15. EBITDA 16. Schwenke

End note
SAVCA CEO, Erika van der Merwe

It has been an immense privilege to interview dozens of executives from such a wide variety of firms for this project. The willingness to share knowledge and to contribute to the broader community were among the first things that struck me about South African private equity when I joined SAVCA just over two years ago.

Erika van der Merwe

Despite being a highly competitive industry, it nevertheless is a collegial one. In my view, SAVCA has, in its capacity of being the nerve centre for this community over the past seventeen years, provided a platform for both deepening and broadening connections amongst its members, including those operating across Southern Africa and beyond.

As this member base has grown over the years and the industry has evolved, SAVCA has developed, too. Its activities and profile have ramped up as it strives towards fulfilling its mission of supporting the industry; its major workstreams include engaging with regulators and legislators, providing insightful research, offering training on new developments and creating networking opportunities. All of these functions are supported by active SAVCA board members and other committed participants, who recognise the importance of ensuring that the industry has a presence to be reckoned with.

It is clear that, in order for our industry in order for our industry to expand further, a wider pool of local institutional investment is needed. Since 2011, South African pension funds have been able to invest up to 10% of their portfolios in private equity, up from 2.5% previously. Despite this positive regulatory change, only a handful of funds have availed themselves of this allocation to date. One of SAVCA's primary objectives is to expand its communication and education programmes designed to inform large and mid-sized local and regional pension funds about private equity. Many of the perceived barriers to investment would be lifted by a deeper understanding of the asset class, dispelling some of the myths and demonstrating the important part it plays in bolstering portfolio returns, ensuring diversification and achieving developmental, governance and environmental objectives.

Offshore investors have been instrumental in supporting the growth of the local industry. The regulatory, compliance and reporting requirements for offshore fundraising have proliferated since the global financial crisis, and fund managers have had to scale up to conform to these requirements. Here, too, SAVCA plays a part, helping to demystify regulation and providing guidance on working within these frameworks. We also engage with our own regulators with a view to influencing their discussions and agreements with counterparts from other jurisdictions.

Regional capital, seated within African pension funds and sovereign wealth funds, constitutes yet another potential source of development for the private equity industry and for the continental economy. Research would suggest that $29bn is available within African pension funds for private equity. Activating this capital through much-needed regulatory reform in various African jurisdictions will unleash a further flow of capital through the continent. It is part of SAVCA's mission, therefore, to support such reform through appropriate research initiatives, through engaging with relevant institutional investors in Southern Africa, through communicating with policymakers in the Southern African region and through sharing best practice with other private equity industry associations operating in Africa.

As has been the case at many previous junctures in the industry's history, this is an exciting time for South African private equity and for SAVCA, too. Our member base continues to grow, with many new members drawn from the broader Southern African region, an indication of SAVCA's increasing reach across Southern Africa and the gradual realisation of its vision for industry growth and significance.

Johannesburg, February 2015

Proudly representing private equity

SAVCA is proud to represent an industry exemplified by its dynamic and principled people, and whose work is directed at supporting economic growth, development and transformation.

SAVCA was founded in 1998 with the guiding purpose of playing a meaningful role in the Southern African venture capital and private equity industry. Over the years we've stayed true to this vision by engaging with regulators and legislators, providing relevant and insightful research on aspects of the industry, offering training on private equity and venture capital, and creating meaningful networking opportunities for industry players.

We're honoured to continue this work on behalf of the industry.

SAVCA
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Ethos' role transcends capital.

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We achieve this through focused collaboration with management teams to create innovative, strategic options.

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The result: enduring businesses and dominant brands. Ethos' conviction, coupled with a 30-year legacy of transforming companies, underpins our reputation as a constructive, valued partner.

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