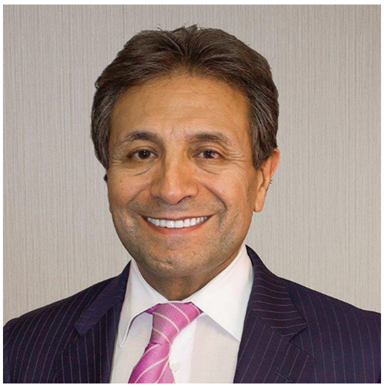
Mezzanine funding finds is place

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."

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.

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