

# Dealing in Abundance

A journal of activity and trends in  
Southern African private equity

2016



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## Editor's note

Abundance. What we represent and what we motivate.

SAVCA's single edition of "Dealing in Abundance" combines the voices of a number of Southern Africa's private equity experts in providing perspectives on the industry. Our purpose with this publication has been to demonstrate the abundance represented by private equity in Southern Africa, through its role in attracting and activating capital from our and other continents, its work – through agile and smart funding – of making the dreams of dozens of business owners a reality, and by transforming companies into healthier and sustainable entities that bring new prospects and positive change to communities and to economies.

The industry has continued to grow steadily over the past year, announcing deals and exits across a number of industry sectors, and of varying sizes and structure. Our feature article, "Dealing in abundance", tells the story of this abundance of activity, and looks ahead to likely trends.

A clear message from private equity, certainly in emerging markets, is that it is built on careful deal selection, which is followed by thoughtful, focused and active management of the business asset. While economic growth may be unpredictable, the private equity manager is intent on making its investee businesses better and more buoyant – despite the macroeconomic circumstances. Our article on the value-adding role of private equity, on "Valuable partnerships", gives some views on this approach. Look out for the case studies, too.

Integral to the strategy of working to make better businesses is the incorporation of environmental, social and good governance (ESG) considerations into portfolio businesses. A number of practitioners in this field share their experiences and practical guidance on how managers go about doing this; see our article "Measuring good: The complexity of ESG management". Also, have a look at the funds featured in our section entitled "Pitch your theme: Private equity changes lives".

We spoke to institutional investors about various aspects of their exposure to the industry, including what their private equity mandate is for the near term, how managers aiming to approach them for capital ought to go about doing so, and what trends they see in fundraising. Their detailed feedback is featured throughout the magazine.

SAVCA is proud of the work it does in championing the industry, which includes tracking and analysing the many regulatory and legal changes that have an impact on the industry, and maintaining dialogue with the relevant authorities on these matters. In "Guiding the industry", we feature a conversation with members of the SAVCA regulatory sub-committee on some of the many facets of their work in this regard.

Putting this publication together has been a fascinating journey, albeit a whirlwind in parts. We thank every contributor, sponsor and partner who offered their thoughts, perspectives and keen insights to this special edition.

We wish you a year of abundance.

Erika van der Merwe,  
CEO: SAVCA

# Chairman's note

The primary vision for SAVCA is to be the champion for private equity and venture capital in Southern Africa. This ranges from startup and early-stage venture capital investments through to private equity deals comprising growth capital and late-stage buy-outs, thus covering the full spectrum of venture capital and private equity.

SAVCA has raised its profile and offering significantly over recent years and there remains much to be done – we are driving to achieve “champion” status, and to be acknowledged as such. With the number of SAVCA’s membership now totaling some 150 members, with full members at 96 and associate members at 54, we are cognisant that we must continue to provide a meaningful offering to all our members in 2016 and beyond.

The private equity industry has been through a prolonged tough period since the commencement of the financial crisis in 2008. There has since been some improvement in market conditions, although difficulties remain. Notwithstanding this, both the size and number of deals completed by the private equity industry in Southern Africa has increased. On the back of the churning of portfolios, some of which have been held in excess of seven years, and with greater interest amongst investors to invest into private equity, we believe that there will be increased investment opportunities in Southern Africa. Infrastructure remains a prime opportunity with huge demand for energy, housing, real estate, water and general infrastructure, and there continue to be opportunities in consumer-facing businesses, financial services and logistics, amongst other sectors.

There has also been an increase in the number of fund closings and in the quantum of capital raised. A significant portion of capital raised by private equity fund managers has been from foreign investors, indicating that there remains an appetite for investments in and exposure to Southern Africa.

Notwithstanding this, given the regulatory hurdles and cost of raising funding in Europe and in the USA by Southern African fund managers, it is critical that new local investors be brought into private equity and venture capital in this region, as they will be the future lifeblood for the continuing growth of the industry. This is especially so where current retirement funds and endowments tend to invest in successive funds of the same private equity fund manager



rather than supporting new entrants into the venture capital and private equity industry. SAVCA is now focusing greater efforts on potential limited partners and specifically on pension funds in Southern Africa, where relatively few pension funds participate as investors in private equity.

To support this initiative, SAVCA recently undertook a survey of a number of the top 100 pension funds in Southern Africa, as a first step towards understanding their perceptions of and exposure to private equity. The resulting publication, entitled “New Frontiers”, adds to the list of reports issued by SAVCA on a regular basis, all of which serve to promote and champion the industry and to keep our stakeholders informed.

In a growing regulatory and compliance culture, there continues to be an increasing abundance of regulatory matters. SAVCA has carried out a vast quantity of quality work through its ongoing engagement with the regulatory authorities, and will continue to do so.

There is great expectation of an abundance of deals in 2016. Yet it is not only the abundance in deal flow that private equity brings, but also the profusion of passion, value add and impact for good that it brings to companies and to the economy of the region. As an industry, we aim to be a catalyst to fostering better businesses and greater growth. SAVCA continues to support the industry in this mission.

Dave Stadler,  
Chairman: SAVCA

# DEALING IN ABUNDANCE

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***Private equity activity in Southern Africa was firm in 2015, with steady deal flow and exit activity keeping funds across the size spectrum busy. Ample investment opportunity remains despite global financial uncertainty, and private equity houses in the region are well positioned to back new deals in 2016.***

In the context of a global search for returns, investors increasingly are exploring opportunities in sub-Saharan Africa and in the Southern African region. Despite subdued regional economic growth, Southern African private equity remains an attractive investment choice for investors with a long-term horizon.

Overall, the sub-Saharan region faced unfavourable conditions in 2015, ranging from weak commodity prices to difficult financing conditions and currency depreciations. Economic activity weakened markedly in sub-Saharan Africa and – while still stronger than many other world regions – the IMF’s latest Regional Economic Outlook for Sub-Saharan Africa puts growth at 3.75% in 2015, even lower than in 2009 in the aftermath of the global financial crisis. The forecast for 2016 is higher, at 4.25%.

Yet, growth in sub-Saharan Africa remains stronger than in many other regions. Lydia Shadrach-Razzino, director at ENSAfrica, emphasises that South Africa remains one of the largest economies in Africa and continues to be “attractive to potential investors given the relative development of our markets and relevant institutions, and despite the current economic and political climate.”

“We anticipate that South Africa will continue to attract private equity investment. As the other countries within the Southern region continue to develop we expect that a similar investor confidence will be experienced in these regions,” she adds.

According to Preqin data, there were 70 private equity-backed buyout deals in Africa with an aggregate deal value of \$1.1 billion in 2015. South Africa saw the greatest proportion of private equity-backed buyout deals (33%) and holds just under a quarter (24%) of the aggregate deal value. In the rest of the Southern African region, Mauritius accounted for 4% of total deal value for the continent, and Zimbabwe 3%. In the venture capital industry, South Africa accounted for 15% of venture capital deals, with only 1% of the aggregate deal value. Meanwhile Mauritius saw 3% of venture capital deals, representing 39% of the aggregate deal value.

Mike Donaldson, director at RMB Corvest, is cautiously optimistic about South African merger-and-acquisition activity and believes that investing in private equity will still offer good value over the foreseeable future. RMB Corvest participates predominantly in transactions involving businesses with enterprise values typically north of R100 million. Donaldson says the segment between R100 million and R1 billion has been relatively active, and “we’ve seen deals happening across the entire value chain”.

*“We’ve seen deals happening across the entire value chain”.*



Mike Donaldson

There was a steady level of private equity transaction activity in 2015, according to Graham Stokoe, Africa Private Equity Leader at EY. Deal flow was robust in certain sectors and the appetite for deals was even better than in 2014: “The combination of buyout and growth capital was dominating the Southern African private equity industry.”

When asked about opportunities in other Southern African countries, Stokoe says that there is a great deal of interest in Mozambique, although he doesn’t see this converting into many transactions at this stage; and, while Botswana remains attractive, he points out that the small economy provides limited opportunities. The commodity-price downturn has rendered Zambia more challenging and, he argues, Zimbabwe appears weaker and more uncertain than it was in 2014.

*“The combination of buyout and growth capital was dominating the Southern African private equity industry.”*



Graham Stokoe

## Hot sectors

Looking at private equity transactions completed during 2015, Shadrach-Razzino says food and beverage, manufacturing, telecoms and logistics were the “hot sectors” in sub-Saharan Africa. When compared to previous years, there has been an increase in investment activity in small and medium enterprises: “While the average deal size typically ranges between \$25 million and \$50 million, we have seen deals in excess of \$50 million over the past year,” she adds.

*“We have seen deals in excess of \$50 million over the past year”.*



Lydia Shadrach-Razzino

“Looking forward we anticipate that the same sectors, as well as healthcare and pharmaceuticals, support services and education, will be attractive to private equity firms. The reason for this can be linked to growth in population, a growing demand for consumer goods and relatively poor performance of the public health and education sectors,” she says.

RMB’s Donaldson mentions “quite a lot of deals” have been concluded in the South African services sector over the last couple of years, predominantly driven by BEE, which for many years now has been an important driver of deal flow. “I think there will be a focus on that sector over the next 24 months. Meanwhile, high-end retail – like luxury goods – is likely to be challenging. It’s a very niche area and could be under pressure for some time,” he says.

In South Africa, Stokoe favours the retail and consumer products and financial services (particularly fintech) sectors, explaining that a number of deals have been concluded in these sectors.

By way of example, in August 2015, Investec Asset Management acquired a significant shareholding in wiGroup, South Africa’s platform provider specialising in point-of-sale integrated mobile transacting. Investec partnered with wiGroup’s founder management and existing shareholder Capital Eye Investments to support the company’s growth and development, both domestically and in new markets outside South Africa.

Another meaningful transaction was Actis’s R760 million investment in Food Lover’s Market, which is estimated to be the largest independent food retail group in Africa. The Actis investment includes funding into the business to continue the company’s growth in South Africa and in other countries within sub-Saharan Africa. This latest transaction is Actis’s fourth investment in South Africa in 18 months, following its recent investments in Coricraft, one of South Africa’s leading home furnishings retailers, Tekkie Town, the country’s leading independent sports shoe retailer, and CSH, a credit bureau and information services business.

On the acquisition front, Old Mutual Private Equity (OMPE) and Ethos Private Equity were also active in 2015. OMPE acquired stakes in In2food, a South African convenience

food manufacturing business; and MoreCorp, a sport, leisure and wellness business in South Africa. Ethos invested in automotive parts retailer AutoZone, pan-African independent shared telecoms towers provider, Eaton Towers, and the Tissue and Corrugate divisions from Nampak. Africa's leading packaging company.

Most recently, Ethos also announced an R1.6 billion investment into The Eazi Group – Africa's market leader in the rental, sale and servicing of work-at-height and material handling solutions, including access platforms, telehandlers and accessories.

"We have been extremely active as a firm over the past 12 months, closing five new investments and realising three," says Ethos CEO Stuart Mackenzie. "A key theme of our approach is identifying businesses that have the potential to outperform despite economic headwinds and then partnering with management teams that strive for excellence in leadership, strategy and execution."

Commenting on the nature of doing business in prevailing market conditions, MacKenzie says: "Periods of increased volatility and complexity require strategic agility to take advantage of the opportunities that inevitably arise, whilst managing the risks".

When asked how managers are taking advantage of these opportunities and sourcing the right deals, Sanushka Chetty, Senior Associate at ENSAfrica, says: "Managers are sourcing deals that are suitable to their respective funds by, *inter alia*, making use of synergies that exist between private equity firms and exploiting various network connections. Some private equity firms have indicated that having teams on the ground alive to the culture and day-to-day living in various regions (particularly in Africa) provides invaluable insight when it comes to sourcing the right deals."

Jacci Myburgh, head of Old Mutual Private Equity, explains that "our origination efforts take into account what we're looking for in investments, which would include a very high-quality management team and a high degree of cultural resonance and partnership mentality. We utilise our highly developed and broad networks as well as world-class research facilities to unearth these opportunities".

Luc Albinski, managing partner at Vantage Mezzanine, says that careful origination of deals is essential in a market in which large amounts of capital have been raised for deal flow, and in which there is the risk of paying what he describes as "uncomfortably high entry multiples in order to secure deals, particularly at the larger end of the spectrum".

***"Private equity managers are responding to these challenges in a number of different ways."***



Luc Albinski

In Albinski's view, "private equity managers are responding to these challenges in a number of different ways. These include looking harder for niche, proprietary opportunities which do not involve auction processes, thinking much harder about sector dynamics and the resilience of target businesses versus the prevailing economic headwinds and equipping management teams with the additional operational expertise required to ensure effective execution."

Albinski and his team have been particularly active in the exits market. Vantage Capital, a pan-African mezzanine fund manager with approximately R8 billion in assets under management, in recent months completed two divestments out of its Fund II – Safripol, Southern Africa's plastic polymer manufacturer, and TrenStar, one of Southern Africa's leading returnable packaging companies.

## Asset realisations driving industry returns

In terms of asset realisations, returns have been in line with the type of returns that investors are seeking, points out Shadrach-Razzino: "Returns from asset realisations have, in the last few years, exceeded listed-market indices."

This is borne out by the findings of the RisCura-SAVCA South African Private Equity Performance Report. By mid-year 2015, the South African private equity industry delivered a ten-year internal rate of return (IRR) of 21.7%, up from 20.5% in March 2015 and 19.1% as at December 2014 (returns are rand-based and are net of fees and expenses). This performance compares with the 17.1% return from the FTSE/JSE All Share Total Return Index (ALSI) over the equivalent ten-year period.

Siyabonga Nhlumayo, principal at Medu Capital, responsible for investment execution and management, comments on the nature of recent exits activity in the market: "In the last 18 months we have started to see more private equity assets being listed for the first time. However, for the mid-market it's mostly sale to other trade buyers or sale back to the entrepreneur, or sale to other private equity funds."

***"In the last 18 months we have started to see more private equity assets being listed for the first time".***



Siyabonga Nhlumayo

According to Donaldson, RMB Corvest has been quite active on the disposal side over the past year. The firm sold its stake in business service provider Servest Group in August 2015, to Kagiso Tiso Holdings and management. The transaction, valued at about R4.5 billion, makes Servest the largest, majority black-owned, facilities management company in Africa, strongly positioning it to expand its footprint across the rest of the continent. Donaldson adds that, just over a year ago, RMB Corvest also sold its stake in South African automotive parts company, AutoZone, to Ethos Private Equity.

## Optimistic assessment

Industry experts are relatively optimistic about future prospects for private equity in Southern Africa.

Old Mutual Private Equity's Myburgh expects the market to remain reasonably active, as a range of investments with 2007 and 2008 vintage are realised and as the significant dry powder of South African and pan-African funds is used.

As a result, he says, we will probably continue to see a fair amount of secondary buy-out activity. The mid-market may also be attractive as entrepreneurs and owners of private businesses may look to lessen concentration risk. Whether realisations to offshore strategic buyers materialise will be interesting to see, as the cheap currency will be considered against South Africa's attractiveness as an investment destination. We would expect more interest from the East than the US and Europe in this regard."

Mark Linington, director for tax at Cliffe Dekker Hofmeyr, also points to the currency effect as being a double-edged sword. "For funds that need to deliver dollar-based returns to LPs, the carry hurdle becomes elusive if exits are concluded at the current exchange rate, even though the portfolio companies have performed well in rand terms." As a consequence, "large exits may be deferred in the hope that things improve. On the flipside, these funds may accelerate acquisitions this year."

*"Private equity remains a force for good and an important alternative ownership option for businesses in all phases of maturity."*

Michael Rudnicki, head of private equity market Southern Africa, at KPMG, expects some of the major South African private equity funds, established during 2006 and 2007, to be prominent sellers of assets in the short to medium term.



Michael Rudnicki

"Some of the more notable private equity houses likely to offload assets are Rockwood Private Equity (South Africa's first spin-out) and Ethos Private Equity. Buyers are likely to range from private equity houses to trade buyers, with the possibility of an IPO in respect of particular assets. Exits to foreign private equity houses will not be a surprise," Rudnicki says.



He explains that a recent visit to many of the leading private equity houses based in London suggests that portfolio companies with growth opportunities north of South Africa and a solid 'partner' base in those jurisdictions, will yield favoured interest.

Donaldson says, "Even within this current climate, we're not going to stop doing deals. We have a few transactions that are in final deal closure, and a few very strong prospects. I think our pipeline is moderately strong, although given the economic climate one has to analyse and select the investments very carefully."

Medu Capital is also looking to close a number of transactions in 2016, that include both exits and acquisitions. "In the next 18-24 months we should be in the position to have fully realised our second fund. The second fund has invested in eight businesses and has had two realisations. We're focused on exits in the remaining six businesses," Nhlumayo says.

"Our third fund is still a relatively new fund, having closed in October 2014. We have two investments on the book and, in the next month or two, will be in the position to report on our new investments. We should have four investments by mid-2016," he adds.

Ethos Private Equity's MacKenzie concludes that "The active ownership model of private equity positions experienced firms to continue to outperform, all the more so in difficult economic environments. Accordingly, we believe that private equity remains a force for good and an important alternative ownership option for businesses in all phases of maturity."



Stuart MacKenzie



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# LP Perspectives

## Sbu Luthuli

Chief executive: Eskom Pension and Provident Fund (EPPF)



### What is your private equity investment mandate for 2016 and beyond?

**SL:** The private equity mandate extends to South African and African private equity.

The EPPF's mandate may be classified into the following categories:

- *Returns objectives:* To generate attractive and competitive risk-adjusted returns over the long term (10 years). On an absolute-return basis the EPPF private equity portfolio strives to return an overall gross internal rate of return in the mid-twenties and a times-money multiple in excess of 2.5 times. The EPPF's private equity return objectives are to further outperform the listed indices over the long term. Empirical research (including the EPPF's internal private equity portfolio) has illustrated that, over a long term, the private equity asset class outperforms comparable listed indices. The performance premium of private equity over listed markets varies from developed markets to emerging markets. Investors exposed to an illiquid asset class, are required to be compensated as a result.
- *Geographical Exposure:* The current mandate restricts the fund exposure to South Africa and the rest of Africa. The EPPF's private equity programme is in its nineteenth year. The fund first invested outside South Africa in 2006. The Fund has since diversified its exposure into the rest of the continent. We have found that it has been difficult to access the potential returns from Africa through traditional asset classes as a result of the lack of depth of the capital markets in this region. The listed markets are not an adequate reflection of the underlying GDP in these economies. Private equity represents alternative access to the long-term growth potential of the African continent. At present the exposure of the EPPF's private equity programme towards Africa excluding South Africa is higher than to South Africa, at R2.6 billion compared with the R2 billion allocated to South Africa. However, we are currently reviewing the fund's allocation towards South African private equity, as our view is that, with the South African economy experiencing a difficult growth period ahead, asset prices should readjust downwards in the interim, resulting in attractive long-term returns for investors.

- *Investment Strategy Focus:* The African private equity landscape is still in the development phase, and there are limited strategies that are employed by GPs. The preferred focus of the fund is growth capital. The EPPF's private equity programme does have some exposure in buyouts, mezzanine and African real estate. The main focus of the fund is on primary investments. Secondary investments and coinvestments that have the potential to enhance the return profile of the private equity programme are considered on an opportunistic basis.

### What are your views on the prevailing regional risks and opportunities?

**SL:** Risks in the region include the low oil price, which will have a particular impact on Nigeria. Other risks include currency depreciation, which has consequences for the entire continent, terrorism (West Africa and East Africa) and the fallout from the MTN saga in Nigeria.

Opportunities for the region include private equity real estate in West Africa, and mezzanine/credit funds in West Africa.

In the origination, sourcing and execution of transactions, most GPs will be exposed to geo-political and macro risks within the African continent. Despite the progress made over the last decade in the governance environment in most African countries, the institutions of state are still in many cases relatively undeveloped. There will be direct and indirect consequences of the political and economic policies of relevant governments where changes in policy could adversely affect investments. It is, however, important to keep in context that there are more than 50 African countries with thousands of ethnic communities, languages, highly divergent economic, political and geographic environments and a varied set of growth drivers. Investing in Africa requires an approach with significant on-the-ground resource and network. The GP manages political risk on a portfolio level, through country and sector diversification.

The recent currency depreciation, commodity price declines and negative sentiment towards emerging markets has resulted in a challenging macroeconomic environment. We

# DEALS IN BRIEF

**Private equity fund manager:** Kleoss Capital and Leaf Capital  
**Business acquired:** TrenStar  
**Sector:** Packaging  
**Stake:** 74%  
**Announced:** January 2016

"Kleoss Capital Fund I and Leaf Capital alongside TrenStar management, have acquired a 26% stake in TrenStar, a South African returnable packaging company, from Vantage Capital. Vantage originally invested in the company in 2010. Both Kleoss and Leaf are first-time equity investors in the firm. Kleoss Capital and Leaf Capital hold a combined 74% shareholding in TrenStar. Kleoss Capital holds a majority stake of this 74%. TrenStar's vast fleet of diverse standard and customised, returnable rental packaging is used in a myriad of industries to facilitate and ensure the packaging, storage, protection and safe transportation of valuable parts and other assets."

are optimistic about the growth prospects over the long term. Most of the EPPF's GPs are not exposed to resource portfolio companies.

Opportunities have been identified in businesses that are able to solve key problems (backlogs) for the African consumer and business or that address the significant supply and demand mismatch. These include, but are not limited to, access to growth capital and quality real estate.

## Are there any new developments in your manager-selection criteria?

**SL:** The EPPF's selection criteria is consistent. The emphasis has been placed on the quality of the GP. The fund places emphasis on investment thesis, the GP's competitive advantage, expertise, value creation and sourcing capability. Furthermore the fund has a transformation objective. There are a number of emerging black GPs with the requisite accumulated experience and expertise.

## In your view, is there a sufficiently diverse spread of institutional-quality managers in the Southern African region?

**SL:** In our view there is not a sufficiently diverse spread of institutional-quality managers in the Southern African region. The EPPF has found it difficult to diversify the portfolio from a vintage perspective.

## What ought to be done about this?

**SL:** Private equity is an alternative asset class and, in South Africa, Regulation 28 was restrictive historically. Private equity penetration as a percentage of GDP in emerging markets is low compared to developed markets. Legislation and economic policies of relevant governments have to be enabling to promote the sector. The mandate of African DFIs has to expand beyond their current scope to include playing a leading role in promoting new entrants and new strategies. We have found that the international DFIs have played a role in seeding new managers in the past. The number of first-time managers has increased over the past five years. We anticipate that the strong quality GPs will survive and weaker ones will fall away. 5

**Private equity fund manager:** Investec Asset Management  
**Business acquired:** IHS  
**Sector:** Telecoms  
**Stake:** Unknown  
**Announced:** August 2015

"Investec Asset Management has made a follow-on private equity investment in IHS Towers, the largest African mobile telecommunications infrastructure provider. Founded in 2001, IHS Towers is a telecommunications service provider, leasing space on towers to mobile network operators.

IHS provides services across the full tower value chain - collocation on owned towers, deployment and managed services. Investec Africa Frontier Private Equity Fund was the first private equity investor to support IHS, investing in the business in mid-2011 along with the FMO, ECP and IFC. Since this initial investment IHS has enjoyed significant growth - from leasing space on approximately 300 towers in Nigeria in mid-2011 to now leasing space on over 23 100 towers in five African countries - Nigeria, Cameroon, Cote d'Ivoire, Zambia and Rwanda."

**Private equity fund manager:** Nedbank Capital  
**Business acquired:** GloCell  
**Sector:** Telecoms  
**Stake:** 32.9%  
**Announced:** February 2015

"Nedbank Capital, the investment banking business of the Nedbank Group, has concluded a private equity transaction for a 32.9% stake in the GloCell Group, a group operating in the South African cellular telecommunication industry. The financial terms were not disclosed. GloCell specialises in prepaid, post-paid and virtual products and services. GloCell serves all South African network operators through 8 000 channel partners consisting of retailers, dealers, wholesalers and through subsidiary Jabba Mobile which distributes product through field agents. GloCell's market reach and brand recognition were among the reasons for this transaction."



## PRIVATE EQUITY DEALS

### Recent announcements

Old Mutual purchases 23.3% of UAP  
from Dr C Kirubi and Centum // 9 January 2015

Metier Capital Growth Fund II makes inaugural  
investment in SA retail chain // 5 March 2015

Ethos invests in automotive parts retailer  
AutoZone // 21 January 2015

Phatisa commits funds to preserve  
woodlands in Zambia // 11 March 2015

Regent Life Botswana takes stake in  
Zambian Oryx Finance // 25 March 2015

Ethos acquires and rebrands Nampak divisions // 1 April 2015

Spear Capital acquires 27% stake in  
Zimbabwe's dairy producer // 11 May 2015

1K1V invests in South African meat producer  
// 28 June 2015

Investec makes further investment in IHS  
// 10 August 2015

TriLinc invests \$16.6m in African SMEs  
// 13 August 2015

PIC, Afreximbank and others invest \$365m in  
telecom group Smile // 8 September 2015

I&P acquires 35% stake in SCRIMAD Group,  
Madagascar // 24 September 2015

PIC invests \$55m in Allied Mobile Africa  
// 16 November 2015

Old Mutual Private Equity (OMPE) acquires 70% stake  
in SA golf and cycling business // 7 December 2015

AfricInvest acquires over 35% in Salvador Caetano  
Auto Africa // 10 December 2015

Old Mutual Private Equity (OMPE) acquires stake in  
In2food // 19 January 2016

Ethos invests in automotive parts retailer  
AutoZone // 21 January 2015

Nedbank Capital invests in SA telecoms group  
GloCell // 12 February 2015

PIC invests over \$80m in solar power projects  
// 8 March 2015

PIC takes 40% stake in education  
provider Eduloan // 23 March 2015

Ethos acquires and rebrands Nampak divisions  
// 1 April 2015

African Infrastructure Investment  
Managers (AIIM) backs Joule Africa's  
renewable energy projects // 7 May 2015

Mergence provides financing to Project Isizwe  
// 2 June 2015

Kagiso Tiso Holdings (KTH) acquires 51%  
equity stake in Servest Group // 25 June 2015

PIC increases Vodacom's ownership to 17.1%  
// 7 July 2015

PIC funds Daybreak Farms acquisition  
// 8 July 2015

Investec takes stake in wiGroup // 12 August 2015

Vantage provides \$28m mezzanine financing to  
Servest // 17 August 2015

Actis takes minority stake in SA furnishing retailer  
Coricraft // 1 September 2015

Kukula and eVA invest in Dot Com Zambia  
// 9 September 2015

Goodwell invests in fintech startup Nomanini  
// 20 October 2015

Actis invests in retail group Food Lover's Market  
// 4 December 2015

Kleoss Capital, Leaf Capital take stake in TrenStar  
// 12 January 2016



Jacci Myburgh

## Transactors Talk

**Jacci Myburgh**, head of Old Mutual Private Equity (OMPE), gives first-hand viewpoints on deal-making.

### What trends do you see around deal-making in Southern Africa?

**JM:** While limited auction processes are sometimes used to ensure some form of price discovery or pricing tension, there seems to be a trend in South Africa towards sellers being willing to engage with buyers on a bilateral basis.


Such a bilateral engagement is viable provided that:

- The price represents a so-called premium price (sufficient to convince the seller that full price discovery is not necessary)
- There is a very high level of commitment from the buyer which is demonstrable. Trust clearly plays a big part here, so it helps if the seller or sellers know the buyer or their reputation
- The buyer would be a good owner of the business and has the support of management.

We have also witnessed over the last two years large pan-African funds increasingly operating in South Africa, as well as traditionally South African-focused funds venturing more definitively into sub-Saharan Africa outside of South Africa. One could say the borders between South Africa and the rest of sub-Saharan Africa have to some extent fallen away as far as private equity is concerned.

A third trend is warranty insurance increasingly being used for the benefit of both buyer and seller. This has arguably led to transactions being to some extent easier to consummate.

### In which deals were you involved over the past year?

**JM:** OMPE concluded three investments in 2015: TiAuto, Morecorp and In2food. All three businesses are retail focused with a bias towards the upper-end consumer. TiAuto and In2food both have strong defensive characteristics while Morecorp has a very distinctive growth strategy that can be executed independently of general economic growth (i.e. a market-share based strategy). We have positioned our fund for a scenario where growth could be quite muted in South Africa over the next few years, so we would be looking for business situations that are defensive or which show attractive growth prospects and potential, independently of general economic growth. 



# South African venture capital records increased activity levels

The South African VC industry shows an encouraging rise in the number of new fund managers, an increase in deal flow and in profitable exits, while deal size declines.

The South African venture capital (VC) industry now represents almost R2bn in assets under management, with healthy confidence levels that are commensurate with reported rising deal activity, a pleasing exits record and a significant increase in VC fund managers and industry professionals.

These findings are encapsulated in the SAVCA 2015 VC Survey, which covers VC-type transactions that took place between January 2011 and July 2015, and follow two previous VC studies produced by the Southern African Venture Capital and Private Equity Association (SAVCA), in 2010 and 2012.

The latest survey reveals that in the 2011-2015 period, 21 public and private VC fund managers and angel investors completed 168 new deals amounting to a total value of R865 million. As at July 2015, total VC assets under management were valued at R1.87 billion, comprising 187 deals.

"The survey results confirm that the South African VC industry continues to expand in line with the increase in entrepreneurial high-tech activity in the market, a deepening pool of skills and experience, a growing exits track record, and lower barriers to entry for VC-type deals, especially for those that target businesses that involve the use of digital technology, e.g. online, e-commerce and new media to expand service offerings," says Erika van der Merwe, CEO of SAVCA.

## Uptick in deal flow activity, a decline in per-deal values

The survey indicates an uptick in the number of VC deals done, from the 11 deals struck in 2012, to 18 in 2013, 34 in 2014 and 43 annualised in 2015 to date.

In line with international trends, the average deal size has declined in recent years: The average transaction value has reduced from R9.3 million over the 2009-2012 period, to R7.3 million during 2011-2015, a decline of 22%. Lean approaches to starting new businesses, which translates into smaller quantities of capital required for transactions, is a key reason for this development. Another reason is the dwindling deal activity by public fund managers and public-funded entities, given that these entities in the past typically have done larger transactions than private sector managers.



## Pleasing exits performance

The survey shows that 56% of fund managers with deals on their books had exited from at least one investment during the 2011-2015 survey period. The average rate of return on investments, for all declared deals that were exited with a gain, is 20% (compound annual growth rate).

The amount declared as write-offs over the survey period totals R187 million, compared with the total value of profitable exits of R438 million.

"The trends highlighted in this survey are positive, in that they signify the advancement of a still-emergent industry that is an integral component of a vibrant and healthily functioning economy – and which is considered a critical enabling mechanism for new high-growth and entrepreneurial sectors and technologies that have the potential to transform the South African economy," Van der Merwe says.

## VC needs visionary public-sector backing

Findings from the survey that public-sector VC funds are reducing their activity is a concern, though.

Stephan Lamprecht from Venture Solutions, who conducted the survey, comments: "Evidence from other markets is that sensible government backing and enablement of seed-stage and early-stage VC activity are vital in ensuring not only the development of the VC asset class, but, more importantly, the growth of high-tech, high-growth entrepreneurial activity. Without visionary and consistent government backing for VC, the industry will at best continue to grow at average and organically driven rates, subject to market pressures and the high risks associated with being an emergent asset class. It is therefore imperative for the transformation of the entire economy that VC in South Africa is harnessed to support improved, more diversified and more sustainable economic growth."



## Other highlights from the survey include:

- As at July 2015, there were 31 VC fund managers, up from 22 in 2012.
- New deals have been primarily driven by independent fund managers, and by angel investors (typically high-net-worth individuals): Angels concluded 55 transactions (33% of total number of deals), amounting to R42.55 million (5% of total value of deals).
- Personal networks are the preferred way to source viable deals.
- Early-stage/start-up businesses account for 51% of deal activity.
- Private sector fund managers collectively have now overtaken government as the primary source for VC-type deals, at 81% of deals recorded in the survey period. However, government-backed investors still represent a significant portion of the value of deals, given the magnitude of their transactions.
- The average equity stake taken by VC investors is 37%. Government investors on average take significantly larger equity stakes (43% average shareholding) than private sector investors (31% average shareholding).
- The average annual rate of return on investments (ROI) achieved for all deals exited with a gain is 20%.
- When exiting VC deals, trade sales (sales to third parties operating in a similar industry) are the preferred mechanism, with the second-most common exit strategy being sale to management.
- There are relatively healthy confidence levels in the VC sector, with two thirds of respondents reporting that they anticipated a profitable exit in the next 12 months, with profitability expectations ranging between two and five times money back.
- In view of the current economic climate, almost all respondents indicate a willingness to wait up to three years for a profitable exit.
- The average investment holding period is four years and seven months. Government-backed investors remain invested for longer compared with private sector fund managers.
- The ICT-type sector accounts for almost half of all deal activity, including software (26%), e-commerce (10%), electronics (4%) and media/entertainment (7%). This is more than double from the previous survey. Many deals in other sectors such as financial services and business and consumer services are also driven by new technologies involving information and communications technologies.
- The Western Cape (75%) has rapidly overtaken Gauteng (20%) as the geographic source of VC-type deals. 

# CASE study



## On the value-adding role of private equity

**Asset:** Tsebo

**Private equity manager:** Rockwood Private Equity

Tsebo is a diversified corporate services company with operations throughout Africa that provides a comprehensive suite of facility solutions including facilities management, catering, cleaning, security, hygiene, energy management, procurement services and mine camp solutions.

Following the financial crisis in 2008, as food price inflation reached close to 20% and the South African economic contracted, Tsebo was faced with its first substantial challenge. The Rockwood team worked closely with Tsebo management to retain its customer base and used the weak market as an opportunity to grow market share aggressively via bolt-on acquisitions and competitive pricing.

Subsequently management, with Rockwood's support, developed an African growth strategy. Tsebo made its first African acquisition in Mozambique and has since grown to have the largest pan-African footprint across 21 African countries including Botswana, Lesotho, Namibia, Swaziland, Democratic Republic of Congo and Nigeria. Tsebo augmented its core business through the addition of complementary services.

Earnings have increased almost five fold since acquisition and the company now employs approximately 32 000 staff at over 7 000 sites across Africa and the Middle East. The African income streams have created a rand hedge as most of the earnings from African markets are dollar-denominated.

Rockwood is evaluating its exit options and has received a great deal of interest from prospective investors who recognize the growth potential as well as the positive and lasting changes that have been implemented in the business.

*Rockwood Private Equity spun out of Barclays Africa in December 2013 in the first secondary transaction in South Africa. The Barclays Private Equity team acquired Tsebo from Ethos Private Equity for R1.4 billion in 2007, in partnership with existing management and empowerment partner Nozala Investments and Leroko Investment Holdings.*

*Tsebo is one of five companies held in Rockwood Fund I, a generalist fund with an African brief which focuses on companies that are expected to outpace South African GDP.* 



# Valuable partnerships

*A distinguishing feature of private equity is its thoughtful, focused and active management of the businesses it acquires. The industry provides capital that is astute and agile, and that helps companies function better and more profitably. Private equity fund managers share their models for value-adding in portfolio assets.*

Private equity capital often finds itself competing for deals against other types of capital providers. Its competitive advantage is in offering far more than capital: for those businesses for which private equity is a good fit, the strategic support, fresh networks and operational insights that come as part of the bidder's package are the factors that ensure that the deal is clinched. The returns track record of the industry – in South Africa, private equity has outperformed listed equity over the past decade – shows that private equity managers are delivering on this promise, and are working hard in partnership with their portfolio companies to find avenues for enlarged turnover growth, earnings expansion and job creation.

The emphasis on the value-adding role of private equity is evident especially in emerging markets private equity, where there is enormous scope to match high-growth potential businesses with the fund manager's perspective and strategic skills. It is also an essential line of approach when tepid economic conditions force businesses to act smarter in order to capture earnings growth.

Siyabonga Nhlumayo, principal at Medu Capital, says his firm is "always focused on achieving returns through capital appreciation, with less focus on gearing or financial engineering. And that could be achieved by improving operating margin or improving earnings".



Siyabonga Nhlumayo

He adds that Medu Capital is investing in companies that are growing and which have the potential to grow further. "South Africa has some established medium-sized companies that have the ability to find exposure to other markets, beyond the relatively low-growth local environment. This exposure may be through the opening of sales offices in other countries, or through the acquisition of assets there".

Nhlumayo's advice for success in a slow-growing market is to ensure sustained competitiveness through a strong focus on improving efficiencies and working capital management. "I think we're all hopeful that, if we grow those businesses right, in the medium term we'll be exiting in a buoyant market."

Ethos Private Equity has a dedicated team of professionals working on implementing its value-add model. Richard Fienberg, a partner at Ethos, says that "our model has evolved from embedding basic disciplines to building capability for sustained outperformance. Our persistent goal is to stretch ourselves and management teams in areas of leadership, vision, and urgency."

Referring to experiences over the past year he says "we've enjoyed significant successes by providing constructive, solution-oriented input. Though some of our interventions have been tough, we've shifted our businesses strategically while directly supporting performance delivery and building leadership capacity".



Richard Fienberg

## Focus on management

The theme of strong leadership, both at the fund manager and at the portfolio company, is pivotal to successful value creation. Andrew Dewar, managing partner at Rockwood Private Equity, elaborates on the level of skilled management at the firm's portfolio companies.

"Strong management is a cornerstone of our investments. Management has to have its own strategy; our role is to support management in implementing the strategy."

"Post-acquisition, we are well represented on the boards of all the companies in which we've invested and we typically have control positions. We work closely with management post-acquisition to implement strategies," he says.

Rockwood Private Equity manages the Rockwood Fund I, a R6.5 billion South African leveraged buyout fund with five portfolio companies: a polypropylene and polyethylene producer Safripol; a household furniture maker Bravo; a facilities management, catering, cleaning and corporate security services firm Tsebo; a waste-management company Enviroserve; and Kwikspace, a prefabricated buildings manufacturer.

Dewar adds that strategies are dynamic in nature, and require the private equity manager to be quick-thinking and adaptable: "A strategy that looked very viable in 2008, didn't look so viable in 2009; and the strategy that looked incredibly feasible at the beginning of last year, doesn't look workable anymore. This is driven by changes in the macroeconomic environment."





Andrew Dewar

Further, strategy is unique to each company, and to the management teams, he says. "You need to align the strategies to the skills of the management teams. The opportunities that are presented in Africa, for example, are fundamentally different for each company, and for each of the regions in Africa. What may be attractive to one company may be completely uninteresting to the next company."

## Complementary talents

Private equity teams in Africa are built on close and trusted partnerships, according to Phatisa joint managing partner Stuart Bradley. Phatisa is active throughout sub-Saharan Africa via its African Agriculture and Pan African Housing funds, with investments ranging from the production of palm oil, eggs and fertilisers, to affordable housing.

"The industry can be exceptionally demanding and this requires working together as a team to tackle the challenges. Truly successful private equity businesses are built upon solid personal relationships that have spanned decades," he says.

Bradley emphasises the importance of diverse but complementary talents in order to ensure a meaningful value-addition process at the portfolio-company level. "Phatisa has a diverse team from various countries and nationalities across Africa and globally. This specialised skill set adds enormous value to our investors and investments across the company."  

# CASE

# study



## The acquisition, management and exit of Plumblink by Ethos Private Equity

Q&A with Jos van Zyl, partner and chief operating officer, and Titi Sekhukhune, principal



Titi Sekhukhune



Jos van Zyl

### How did you come to acquire the company?

Plumblink is a plumbing and sanitary ware merchant which we found through our Ethos networks. We acquired the business in 2006 through our Ethos Fund V, alongside management from the company and a BEE partner, Innovative Sanitary Solutions.

### What was your initial long-term strategy for the company?

The investment was made based on the market growth outlook and the positioning of the company at that stage. We were focused on two factors:

First, the attractive macroeconomic and industry environment. These included increased government and private sector infrastructure expenditure; expansion of a black middle class, which was expected to underpin growth in residential construction; and government programs focused on providing low-cost housing.

Secondly, we were attracted to the company's positive attributes. Plumblink had a unique national footprint servicing large construction customers; offered competitive pricing due to scale and purchasing power; and had a strong knowledge base, enabling it to offer essential technical advice in complex plumbing situations.

### What happened during the financial crisis?

Plumblink was negatively impacted by the global financial crisis because the sectors it serviced were affected. As a result, Plumblink experienced pressure on both volumes and pricing.

Furthermore, we also saw some "own-goals" at the company, mainly owing to head office and regional management departures.

### What were some of the strategic changes you considered and eventually made during that time?

We took on the challenge of addressing these headwinds on a number of fronts. In particular, we made changes in the following areas:

- The company's management team, by bringing on new talent
- The business model, to build a more defensive business
- Expanding the Plumblink footprint and store sizes and layout
- Improving operational efficiency to reduce costs
- Financing and working capital management
- Information systems
- Customer segmentation

*"Be stubborn about your goals, and flexible about your methods."*

### What was the exit process?

We exited Plumblink in 2013. Ethos commenced an auction process following expressions of interest from multiple parties, and JSE-listed Bidvest was successful in their acquisition.

As a strategic buyer, Bidvest was well-positioned to further add value to the Plumblink business. There was a good fit with similar businesses within the Bidvest group of companies.

### What were some of the lessons you learned?

Plumblink is a fine example of perseverance from both management and private equity partners. Our steadfast collaboration was the difference between success and failure.

Together, we had to live by the adage "Be stubborn about your goals, and flexible about your methods."

**Ata /' â•t•â/ (verb) :**  
A Sepedi word meaning 'to grow'

.....

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# Which Way to the Exit?

**Natalie Kolbe**, a partner at Actis LLP, shares her thoughts on the current exit environment in Southern Africa and some of the risks and opportunities facing private equity funds in the region.



Natalie Kolbe

**We saw a rise in exits in 2014 and 2015 -- why do you think that happened?**

**NK:** The African private equity industry has consistently been exiting 25 to 40 businesses per year historically. Recently there has been a spike in exits. My hypothesis is that the delayed impact of the global financial crisis on Africa could explain some of the recent heightened activity. The financial crisis hit the Western world in 2008-2009, but in Africa we really felt it around 12 to 24 months later. In the early part of the crisis, there was a downturn in exit activity as buyers waited for the crisis to play out. Throughout 2010 and 2011, as the crisis filtered through to the continent, the actual performance of businesses then suffered, making exits difficult.

Post the downturn, companies needed to show a few years of growth to attract buyers, hence why I suspect we are now seeing exits picking up again.

**As we go into 2016, is there any single keystone issue facing private equity funds looking for exits?**

**NK:** Currency depreciation and access to foreign exchange are the two biggest risks we face on exits at the moment. For example, the depreciation of the rand has really had an impact on private equity dollar returns. Investors are asking themselves if they ought to wait in the hope that currencies rebound.

**What are some of the other risks you're keeping an eye on?**

**NK:** The risk is of "shifting sands" of our markets, could impact on the ability of a private equity firm to exit investments – these are the critical changes happening year-to-year in the economic and political landscapes. Elections are a major consideration: buyers are likely to be more cautious ahead of an election, preferring to adopt a 'wait and see' approach. We saw this play out in the run-up to the Nigerian election in 2015, and we might see it again, which can affect the timing of an exit process.

General market volatility can also impact exit timing. For example, if you are currently invested in a business exposed to the oil price, it's unlikely that you'd have a queue of people lining up to buy your asset right now. Any time we see a fall in a major commodity or geographic market, buyers tend to wait to see what will happen next.

Regulatory uncertainty can also be a risk. Operating in a regulated environment, *per se*, is not an issue; but, a lack of clarity or regulatory uncertainty can cause an issue around exits, which can be compounded when a new government comes in to office. A new government is likely to make a number of changes to regulation in line with its policies which can fuel uncertainty. Investors need on-the-ground presence, strong networks and an understanding of the cycles and of local nuances. There are industries that remain very resilient and defensive against this uncertainty: if you pick the right investment opportunities and have a clear perspective on where potential risks lie, there are attractive returns to be made.

**Do you think these risks will have an impact on the exit environment?**

**NK:** To date, the exit environment in Africa has been robust. We have had sufficient and varied routes to exit and, although the current uncertainty in emerging markets may cause investors to pause, ultimately good businesses will always find a buyer. It may take a little longer, and we have found that the average investment period for African private equity firms tends to be a little longer when compared to international peers.

However, regardless of the risks, there are a number of positives in Africa that will continue to attract buyers. Favourable demographics of a large, young and growing population base continues to support the growth in consumer-facing industries. As the economic strength of the consumer base grows on the continent we'll see more interest from both private equity and trade buyers looking to consolidate market share and to provide capital and resources to help regional companies grow.



## PRIVATE EQUITY EXITS

### *Recent announcements*

AfricInvest, Abraaj exit UAP to Old Mutual  
// 27 January 2015

RMB Ventures and Pan African Capital Holdings  
exit Denny Mushrooms // September 2015

Carlyle sells its stake in Export  
Trading Group // 27 June 2015

Actis exits Globeleq Africa to CDC  
and Norfund // 14 September 2015

Ethos sells out of Transaction Capital  
// December 2015

Vantage generates over 2x returns from  
Safripol exit // 9 April 2015

CVC exits Virgin Active to Brait  
// 17 April 2015

Abraaj exits UAP to Old Mutual  
// 6 July 2015

Helios exits Continental Outdoor  
Media // 18 June 2015

Ethos exits Plumblink  
// 11 June 2015

Vantage exits TrenStar  
// 12 January 2016

Adenia exits Hôtel du Louvre (Madagascar) and  
winds up Fund I // 2 November 2015

Ethos exits CQS to JSE-listed  
Adapt IT // 27 January 2016

The increase in urbanisation will also ultimately make it easier for companies to target and access their customers, making it easier for them to deliver goods and services. This is an attractive trend from the perspective of multi-national buyers, who want to access the large number of consumers living in cities.

For many foreign investors, Africa is seen as the last frontier. It represents a source of untapped opportunity of which people want to be a part, so I don't think we'll see a loss of interest despite some of the short-term risks and complexities.

#### What are the likely future exit trends?

**NK:** I think we'll see exits continue to rise. This will be driven partly by exits to other private equity funds. There has been a wall of capital coming to the continent and that money needs to be deployed, which will support the exit environment. In the western world, 30-40% of the private equity exits are recycled within the industry, whereas in Africa this is currently still a small portion of exits – but likely to increase.

*"Overall, the long-term exit environment in Africa is robust and our outlook is positive."*

There is also more interest from multi-nationals. In 2014, exits to multi-nationals jumped to 50% of trade sales, from 27% in the prior three years. Environmental, social and governance (ESG) gains are an important consideration. One of the major benefits that private equity investment offers is its focus on improving systems and governance, which is very attractive to foreign multi-nationals. Trade buyers are already a prominent exit route, and we are likely to see more multi-nationals entering the market over time.

Also, while it isn't a major exit route now, we have seen improved liquidity on the African stock exchanges over the past several years. This will start to influence exit decisions over time as public offers start to compete with other exit routes.

Overall, the long-term exit environment in Africa is robust and our outlook is positive. [5](#)



# Measuring good: The complexity of ESG management

*Driven to a large part by the significant role of development finance institutions in African private equity over dozens of years now, private equity working on the continent has an established track record of environmental, social and governance (ESG) management.*

Though it is a complex and serious undertaking, a growing number of African funds are embedding an ESG process as a core component of the overall investment process.

## Why ESG matters

"We see environmental, social, and governance factors as key potential risks that can be mitigated through appropriate management," says Michael Goldblatt, an executive at Metier, and an advisor to the Lereko Metier Sustainable Capital fund.

The sheer size of even small infrastructure projects makes ESG doubly important for infrastructure investors. Dean Alborough, ESG Specialist with African Infrastructure Investment Managers (AIIM), notes that the visibility of large infrastructure projects means that flying under the radar of local communities is rarely an option.

"A key aspect of whether you're able to sustain yourself as a business is a social license to operate. If you don't get buy-in from the surrounding community, you will likely not be able to construct or operate your asset."

Flying under the radar might work for a time, he says, but avoidance is a far cry from risk management. "Characteristically, if something goes wrong [from an ESG perspective] it can potentially go badly wrong," says Alborough. "In some cases it can go from absolutely okay to disastrous fairly rapidly – there can sometimes be little middle ground. And once you've lost your social license to operate, it's not easy to regain it."

## Building sustainably profitable companies

ESG is about more than risk management and community buy-in. It's also a key element in building better companies -- without losing sight of the profit motive.

Therese Niklasson, global head of ESG with Investec Asset Management, puts it this way: "From our history of investing in Africa, we have learnt that an investment that can demonstrate good ESG operational performance will generally have a better overall operational performance. This is because ESG affects all aspects of a company, from the board structure and director independence to the labour-related issues, which may cost the company in lost time, or the wasteful use of resources."

Michael Hall, sustainability manager with London-based Development Partners International (DPI), says, "We have to be able to find a way to do ESG and still be profitable and still be efficient." His advice is that, when speaking to investors and portfolio company managers alike, fund managers "absolutely have to make the business case because otherwise it appears to be an added-on thing – rather than the way the company should be doing business."



Hall notes that meeting international standards is rarely so costly that it is impossible. "You have to build it in and be smart about how long it's going to take you to get there, and usually it's reasonable. And where it's not, you can always find a smarter way or a more efficient way of going about it."

When portfolio companies push back on the potential cost of new initiatives, Hall considers it a good sign. "I think that's really healthy. If someone says to you, 'This is going to cost me X amount of money and I don't think that's right,' that's the best conversation someone can have with you," he says. "Because then you actually have financials to work with, which is sometimes rare with ESG issues or ESG management. Then you'll be able to measure at the end the outcome of that and whether or not it's worth it."



Michael Hall

These steps can be applied not just internally, but also to the value chain surrounding a company. An example, detailed in SAVCA's 2015 Case Study Compendium, is Phatisa's investment into Goldenlay, Zambia's largest egg producer. Whereas an investor in an American egg producer might focus on tweaking operational controls and enhancing efficiency, Phatisa's scenario involved everything from addressing health and safety risks to improving financial controls and to establishing a more stable and secure supply chain.

Stuart Bradley, joint managing partner of Phatisa, says, "There is an opportunity to build robust value chains in ways that build lasting economic nexuses between the informal, semi-formal, and formal economies and which allow for greater value capture and retention within Africa."

The story is a wonderful illustration of the powerful synergies that can arise from blending business with sustainability.

## The devil is in the detail

However, good intentions and business soundness aside, managing ESG initiatives and communicating with limited partners (LPs) and other stakeholders is not always straightforward. How does one assign metrics and performance measures to such an involved process?

A PwC survey of 60 LPs in 14 countries (who together allocate about \$500 billion to private equity) found that while 83% of LPs count ESG management as part of their fiduciary duties and 97% include ESG assessment as part of their private equity due diligence process, only 31% regularly use the international UNPRI ESG Disclosure Framework. When asked why, responses varied from concerns around overwhelming fund managers with onerous reporting to the difficulty in analysing large volumes of ESG-related data.

In a sense, even LPs who are deeply interested in the matter are at a loss. Part of the issue is the inherent complexity involved with measuring subjective notions like "impact". Instead of simplifying, Alborough says, "These are complex systems, and we need to try to understand them as complex systems."

For socio-economic impact measurement, he says that there is no shortage of indicators, but that one has to choose the right indicators for the right reasons. A well-accepted approach is to work backwards using the Theory of Change. "The model generally works left to right: you have inputs, outputs, and then outcomes and impact. You've got to start on the impact side and you say, 'Okay what is the impact we want to have?'" From there, he says, you consider the outcomes which will have the impact, then the outputs that will lead to those outcomes. And finally, one considers the inputs required to achieve the outcomes.



"In that process you can find which indicators will best and most closely measure the final impact you're trying to understand."

There is also inherent complexity across individual businesses. African private equity funds tend to diversify fairly broadly – whether geographically or by industry – so managers must remain sensitive to the nuances of ESG issues across differing portfolio companies. Hall says, "We engage with companies based on our understanding of what they do," monitoring outcomes against DPI's internal expectations for the company.

To effectively manage risk, he says that fund managers should be aware that ESG issues cannot simply be aggregated into topline metrics or indicators. "You cannot only distill an aggregated number and give a 'yes' or 'no' answer, as you are dealing with a large volume of qualitative data. To manage ESG well you need the resources to be in the detail. As much of it is qualitative information, the devil – and the opportunity – is in the details."

## The keys to ESG

Today, ESG is far from a silo or a checkbox; rather, it is an integral part of the African private equity landscape. Making it work on both a societal and business level requires a great deal, however.

First is a need for total commitment. "Despite the need to be detailed, the starting point is actually to take a holistic approach to ESG management, because not all risks are easily quantified," says Alborough. Even if companies take small steps, it is important to continually learn and to develop systems and processes to understand ESG issues, and to take a broad sustainability perspective of what is involved.

Funds must also show a willingness to engage deeply with their portfolio companies to understand the risks and measures that are appropriate to that business. Bradley says, "ESG integration is not a template-based exercise, but one that is dictated and driven by the needs of the portfolio company. So, it is less about right and wrong and more about proactively implementing international standards and guidelines."

*"I don't think that you can make money in Africa without taking care of the E, the S, and the G."*

Rather than money, then, what ESG requires most is time, and for committed funds the payoff is there. David Ashiagbor, coordinator of Making Finance Work for Africa, says, "I don't think that you can make money in Africa without taking care of the E, the S, and the G."

He says, "It's integral to investment. You can call it risk-management, you can call it whatever it is, but if the E, the S, and the G aren't working, your investment isn't going to work." Considering its complexity, funds may have to venture far beyond the spreadsheet in communicating and understanding the way these factors make an investment work. As a result, as Hall notes, communication about ESG with LPs "is quite often a narrative description, rather than a numerical one".

Thus it may be that, when it comes to ESG reporting at least, LPs expecting to see a spreadsheet may very well be drawn into a rich and complicated story. [5](#)

# What are some of the most important ESG metrics on which you keep an eye?

**Therese Niklasson**, global head of ESG, Investec Asset Management and **Christoph Scaife**, ESG analyst, Investec Asset Management

The most important ESG matrices which are considered for an investment are those that show a fully integrated approach to addressing ESG considerations in a “cradle-to-grave” approach. The risks and issues addressed within the matrices will vary depending on the nature of the business and to an extent location. Companies that have taken into account the whole production or operational lifecycle of their company, from suppliers to consumers, are attractive to investors. International certification bodies have a key role to play through setting standards that are measurable, comparable and auditable across various sectors.

Other key considerations include board independence and labour metrics, namely the number of women in senior positions, permanent jobs and work force diversity. Improved operational performance indicators, such as resource efficiencies (electricity and water consumption) are also important. Again, the metrics here will vary by business activity and sector.



Stuart Bradley



Mike Goldblatt

**Mike Goldblatt**, investment executive, Metier

For social governance, one of the metrics we look at is the percentage of revenue spent on economic development and socio-economic development in the local area. However, this does not necessarily reflect the impact of this expenditure, nor the local perceptions of this expenditure.

For this, more qualitative approaches are needed, as well as more refined quantitative measures (such as numbers of recipients or measures of impacts on recipient – for example, training qualifications gained). These qualitative approaches include interaction with local stakeholders and this requires quite significant time and human resources, or alternatively the use of trusted consultants.

An example is a hydropower project in Uganda in which the Lereko Metier Sustainable Capital Fund is considering an investment. Quantitatively it has been possible to evaluate compliance with best practice in land compensation through documentary evidence; however, qualitatively it is harder to assess community satisfaction with the process. This is being addressed through site visits and engagement with community leadership and through the placement on site of an ESG coordinator who will work within the local community for an extended period of time developing a social responsibility plan for the project.

**Stuart Bradley**, joint managing partner, Phatisa

Phatisa tracks various metrics at its portfolio companies, including capital invested, land size and outgrower land, number of employees (split by gender), number of small-holders or vendors impacted, technical assistance provided, output tonnes, sales revenue, profits, and taxes paid.

We also rely on more discursive analysis and case study reporting to help elucidate the development impact of our investments. [5](#)



Lydia Shadrach-Razzino

# Growth zone

Given burgeoning investor interest in Africa, **Lydia Shadrach-Razzino**, a director at ENSAfrica, provides perspective on the role that private equity is likely to play in African deal-making in coming years.



**Are there any trends in deal-making in Southern Africa that are different from what we're seeing on the rest of the continent?**

**LSR:** There has never been a greater interest in private equity on the African continent and we continue to see a strong focus on Africa from investors. During 2015, there was a surge in African fundraising activities. Many investors view Africa as one of the most attractive emerging markets.

There are different drivers within each African region which create opportunities for private equity, which ultimately determine investment trends. At the moment, the common trend across Africa is very consumer focused, e.g. foods, beverages and fast-moving consumer goods. This is not surprising given the rapidly expanding nature of African markets.

However, there are differences: funds in Southern Africa are usually larger, given the developed nature of the private equity industry in this region. Funds in East and West Africa tend to be smaller, resulting in smaller transactions.



**What are your views on the exits track record in sub-Saharan Africa?**

**LSR:** In the context of Africa as a whole, private equity is in a phase of relative infancy. Other than the JSE, African stock markets are small and are still relatively illiquid. As a result, there is a widely held perception that exits in Africa are or will be difficult to achieve.

However, statistics show that there have been a number of exits across the African continent, and not only in more developed markets such as South Africa. African private equity funds are beginning to make effective use of the practices common in many other markets to enable exits.

Key among these is ensuring the continuity of management teams or clear succession planning. Private equity houses in Africa are leveraging their contracts and relationships to cast the net ever wider in the search for the right buyers for their businesses.

*"Private equity houses in Africa are leveraging their contracts and relationships to cast the net ever wider in the search for the right buyers for their businesses."*



**What are your views on prospects for 2016 and beyond?**

**LSR:** Africa is one of the fastest-growing investment regions in the world. As the continent's markets mature and investment grade opportunities arise, the benefits of investing in Africa are multiplied.

The ease of concluding private equity deals in Africa is rising as traditional barriers to entry gradually break down and as African private equity managers expand their track records. Private equity will continue to offer unique and stable investment opportunities into Africa, with African private equity funds anticipating strong returns.

Exits, too, will become easier as Africa becomes more of a mainstream destination for the bigger private equity managers, which can take over positions from smaller specialist funds, and as capital markets develop and facilitate initial public offering exits. [5](#)



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# Inspired by infrastructure

*Paul Frankish, investment director at Africa Infrastructure Investment Managers (AIIM) and Dhesen Moodley, investment director at AIIM, see lively, large-scale activity in infrastructure-themed private equity.*

## What trends do you see around infrastructure deal-making in Southern Africa?

**AIIM:** We have seen more liquidity in the infrastructure equity market than before, with a deeper market of buyers that includes internationals shopping around for the first time. Outside of renewable energy, we see a limited international appetite for greenfields infrastructure investments, as these investors prefer assets with a strong track record. Portfolio sales (having two or more similar assets) also appear to be interesting to international investors, both on ticket size and diversification merit.

Local institutional investors' appetite and understanding of the infrastructure asset class is improving, and these investors increasingly are willing to take greenfield risk.

Pricing in Southern Africa in 2015 was materially more competitive for infrastructure equity deals than before, though the same cannot be said for debt. Pricing is strongly influenced by the competition of the renewable energy bid programme. Equity pricing is arguably too aggressive, in that construction risk and long-term energy yield forecasting risk may be optimistically priced by some buyers.

Renewable energy bid pricing has been influenced in the last couple of years by international utility and independent power platform plays, with an aggressive intent to secure assets. Their appetite was slightly tempered late in 2015 as rand weakness resulted in hard currency investors' enthusiasm backtracking slightly. The 2016 market volatility will shake things up more – and we have yet to understand how the market will be pricing uncertainty this year.

## In which deals were you active in 2015?


**AIIM:** We were successful in four renewable energy bids – three wind and one concentrating solar power – amounting to a total equity commitment of around R1.5 billion. We made several disposals in transport.

## Which sectors will be attractive in 2016-17 and why?

**AIIM:** Renewable energy has a lot more legroom in South Africa. Even if international appetite starts to dry up, there is sufficient local appetite and understanding of the risks to support more investment. Equity investment is sized right for large wind projects at around R1.3 billion equity and R400 million for solar PV. Some challenges such as grid connection complicate matters, but these can be unlocked with appropriate government focus. Another area that needs more policy certainty is the nuclear programme – procurement and financing challenges aside – which should not crowd out the proposed extension of the renewable energy programme.

Maintaining the momentum of the renewable energy programme is great for Team South Africa, because the national renewable energy portfolio is now making a meaningful contribution to baseload demand needs, and can do much more. Successfully building more projects sends out positive waves that South Africa can step up to its infrastructure deficit challenges.

The success of renewable energy is also being picked up by neighbouring countries such as Ghana, Namibia and Botswana.

Other than renewable energy, the main deal flow will emerge from power generation, especially the gas to power programme for South Africa. We see potential investment opportunities in pipelines, terminals/storage and power generation in South Africa, as well as across neighbouring countries such as Mozambique. 



Paul Frankish

*"Local institutional investors' appetite and understanding of the infrastructure asset class is improving."*



Dheseen Moodley





# The economics of fundraising for Africa

*Private equity fund managers have their work cut in negotiating fund structures and terms that meet their investors' mandates – and that also make for viable and sustainable business models.*



J-P Fourie



Herc van Wyk



Lelo Rantloane

**E**stablished and new managers operating in a range of regions on the African continent, and who are galvanised by the growth and returns opportunity in their markets of expertise, have in recent years been promoting the private equity asset class to institutional investors – many of whom have declared their interest in initiating or expanding their African allocations.

Though the region is still relatively new terrain for the private equity asset class, certainly compared with the long history of private equity in developed markets and even in some other emerging market regions, investors have a wide range of fund managers from whom to choose in order to fulfil their allocations.

“There are a number of institutional-quality private equity fund managers operating across the continent,” says J-P Fourie, head of investor relations at Metier. “This is testament to the amount of capital that the industry has raised over many years, and to the returns track record of the asset class.”

Even new fund managers, who have pulled together experienced team members to work towards raising a first fund, are attracting the attention of limited partners (LPs) who recognise that insisting on “institutional quality” does not necessarily rule out newcomers.

Herc van Wyk, CEO of Pembani Remgro Infrastructure Managers, says raising a first-time fund for Africa is particularly difficult, though, and that “there is often a higher level of natural initial scepticism from investors to overcome”.

“It was especially difficult when one dealt with individuals [at LPs] who have never been to Africa before, and it introduced another level of information to be shared regarding perceived increased political, governance and currency risks. To us it helped significantly to involve shareholders such as Remgro and Phuthuma Nhleko, both with established track records in the region.”

The Pembani Remgro Infrastructure Fund had its first close in May 2015.

Lelo Rantloane, CEO of Ata Capital, observes that it continues to be a challenging environment for first-time managers, who find it difficult to motivate how the individual track-records of the team members will make them a great team.

“We have found that, in the current environment, LPs are less likely to be swayed by a great idea and are more likely to be won over by a team that they trust based on track-record and skill.”

Rantloane’s advice is for new managers to consider focusing their energies on one or two anchor or seed investors – who often tend to be more entrepreneurial – and who would be comfortable with the approach of allowing the team to build a track-record ahead of raising third-party funds.

## Push-back on terms

Nicole Paige, a partner at Webber Wentzel, notes that LPs' requirements for first-time managers tends to be much more onerous than they are for more established managers – and has seen that there is a great deal of push-back on legal agreements and commercial terms from LPs. "In a context where it's all about being competitive relative to other fund managers, the new manager can't push back too hard and risk losing the investor, and it becomes a fine line of pleading one's case on what is feasible commercially, and of ensuring that funds are raised."

Van Wyk sees this as an opportunity, having, as he says, "come across a few large and active investors who actually state a preference for first-time managers, as they regard them as being more 'hungry for success', which creates scope for the LP to negotiate more preferable fund terms".

## Paying the bills

Paige's point about the commercial feasibility of a fund is one that managers weigh up carefully. The fund sizes targeted by the investor relations team are a factor of the fund focus and of the resources required to fulfil that mandate.

The fundamental economics are that the fund size should cater to a sufficient number of portfolio assets – around eight to twelve, typically – to ensure diversification," says John Bellew, head of private equity at Bowman Gilfillan. "The average deal size, in turn, depends on the segment in which the manager operates.

He elaborates on the criteria for optimum fund size: "Funds targeting large transactions obviously need more capital to achieve the required diversification, whilst funds focused on smaller transactions must raise enough capital to achieve diversification, but not so much as will result in there potentially being too many deals in the portfolio to manage properly."

Too big a fund may also result in the manager becoming less selective in the deals it chooses in order to invest the capital in the fund, he says.

Furthermore, management fees, typically 2% of the fund value, have to be sufficient to cover operational expenses – including salaries of investment professionals, administration staff and premises. "A manager running multiple offices in various countries may need a bigger fund to cover overheads," Bellew says.

## Competing interests

Paige says that, with the increasing numbers of managers raising capital for Africa-focused funds, there is a growing element of competition for managers – including those focused purely on Southern Africa. "Development finance institutions (DFIs), for instance, have a certain amount of capital to allocate per year. With some big names in the international industry moving their sights to Africa, and with new managers emerging, there is more competition."

Also, there are nuances in LPs' interest in African funds. Bellew says "international LP appetite and trends are driven partly by perceptions of yield: while some like the South African story, others are looking to take on broader African risk with the view that this will provide better results".

Van Wyk says his team found that "most investors would not make a distinction between Southern African funds and sub-Saharan African funds", treating them all as falling in the 'African' investment bucket.

Also, there are nuances in LPs' interest in African funds. Bellew says "international LP appetite and trends are driven partly by perceptions of yield: while some like the South African story, others are looking to take on broader African risk with the view that this will provide better results". [5](#)

# Know your investor

*Development finance institutions (DFIs) traditionally have been firm supporters of private equity in Africa. Commercial investors have in recent years started taking on exposure to the asset class in the region. How do these two classes of investor differ in their approach to fund managers?*

**Herc van Wyk**, Pembani Remgro Infrastructure Managers:

"In our experience it was very important to involve at least one anchor DFI at the outset. It firstly ensured that the fund terms are market-related – DFIs have much more experience and exposure in setting up funds in Africa, and hence a greater awareness of prevailing best practice – and it also provided a level of comfort to commercial investors that the Fund has been through a certain level of due diligence."

"We found the requirements of the DFI investors to be far more onerous and very detail orientated, not only with regards to ESG requirements, but also other commercial terms. It was, however, beneficial to the fund as several commercial investors took comfort that those areas would have been adequately addressed by the DFI investors."

**Lelo Rantloane**, Ata Capital:

"Different DFI's will have different mandates depending on their particular international and regional agendas and priorities at a particular point in time. In most cases DFI's will be required to strictly adhere to these priorities, which at times may be contrary to a GP's business case. Whilst commercial investors will be more flexible in terms of following certain investment themes at different times, DFIs will not have that luxury and may therefore seem inflexible. GPs should therefore understand the mandate of a DFI before pursuing them as an LP."

"Because DFIs generally have a greater agenda than just financial performance, they have historically been perceived to be more onerous in terms of reporting and compliance. However, this is increasingly true for commercial investors as well. Therefore, GPs should aim to hold themselves to the highest standards of reporting and compliance." [5](#)



# LP Perspectives

**Anne Keppler**

Vice President Corporates & Funds Africa, Equity and Mezzanine: DEG

## What is your private equity investment mandate for 2016 and beyond?

**AK:** DEG's private equity fund strategy for 2016 focuses on mid-cap funds, which may be generalist or sector-focused. By mandate, DEG must be involved in the first closing of the fund and be granted at least one seat on the fund's advisory committee. For DEG, co-investments are an important element in its strategy for fund investments. For fund managers, co-investments increase the size of investments that the fund can make. They also provide better access to the value-add which DEG can bring to an investment, such as its global network of more than 700 clients across all sectors and its comprehensive knowledge of the economic and political conditions in partner countries. Furthermore, DEG provides sector experts environmental and social (E&S) expertise and business support services. DEG has 13 offices in emerging markets, it is a subsidiary of KfW, the promotional bank of the Federal Republic of Germany. Based on an equity and mezzanine portfolio of close to \$1 billion (of which roughly one third is in private equity funds) we plan to invest up to \$200 million in Africa in 2016 - in addition to DEG's senior loan program.

## What are your views on the prevailing regional risks and opportunities?

**AK:** In 2015, Africa admittedly had a somewhat tumultuous year in terms of currency depreciation and market volatility. These short-term movements have not dissuaded us from our broader strategy, which is to meaningfully increase our exposure in emerging markets, and invest long-term, patient capital that enables sustainable success. Be it in our fund or direct investments, we view the market corrections as an opportunity rather than a crisis.




Anne Keppler

## Are there any new developments in your manager-selection criteria?

**AK:** DEG's manager-selection criteria focuses on a robust, cohesive and dedicated fund management team. Previous fund experience and a strong track record goes a long way in illustrating the characteristics of the fund managers with whom the DEG likes to work. However, DEG often serves as a vital source of capital to first-time managers, or managers in frontier markets, who otherwise struggle to attract institutional investors. Our experience and cooperation with new, professional and disciplined fund managers is generally very positive and encourages us to continue with this strategy.

## In your view, is there a sufficiently diverse spread of institutional-quality managers in the Southern African region?

**AK:** Over the years, the Southern African private equity market has transformed for the better with respect to the diversity of quality managers. A large number of African private equity professionals who mostly received their training abroad, are enticed by the activity and opportunities offered by the African private equity market. There are also an increasing number of professionals who have come up the ranks in the local private equity, banking and advisory institutions. However, the region is still in a stage of transformation and more can be done to facilitate knowledge and expertise sharing.

Selected limited partners (LPs) that operate within the Southern African region could work together to form a private equity fund manager incubation program, that facilitates knowledge and skills transfer to promising private equity fund managers. 





# FINDING CLOSURE

**Nicole Paige**, a partner at Webber Wentzel, has overseen the formation of dozens of private equity funds in recent years. She tells us what's happening on the ground.



Nicole Paige



**What has been the overarching theme in fundraising for private equity in Southern Africa and sub-Saharan Africa over the past year or so?**

**NP:** We have acted on behalf of several funds that have reached successful first and final closings over the past year. These have highlighted the importance of being able to attract development finance institutional (DFI) investors in order to reach minimum fundraising targets and gain traction with commercial investors. We are seeing more specialised funds as fund managers seek to differentiate themselves from their competitors. This is particularly the case for smaller funds. Fund mandates tend to be regionally focused, as opposed to investing only in a single country.



**What fundraising developments do you expect to play out over the coming year or two?**

**NP:** Fundraising may be difficult in the next year, particularly for SA managers that need to give a dollar return to offshore investors. The AIFMD regulations in Europe will continue to make fundraising difficult in Europe, and fund managers may look more to the US and other markets. We expect to see fund managers be more innovative in respect of fund structures, particularly looking at evergreen options in the infrastructure/energy space where the traditional ten-year fund structure is not always suitable for the profile of the investments. [5](#)



**Are you seeing a new breed of limited partners (LPs) coming to the market, or is the LP profile today similar to what it was, say, five years ago?**

**NP:** While DFI investors are still very prevalent, there has been a marked increase in the interest shown by fund-of-funds investors in sub-Saharan African funds and, compared to five years ago, there are certainly far more foreign commercial investors investing into sub-Saharan African funds. Also, while some of the largest local pension funds have been active participants in private equity for some time, we are now seeing a wider range of pension funds (in South Africa, as well in other sub-Saharan countries) investing in funds.





# *Diligent investors*

A number of factors influence and inform the due diligence process undertaken by an institutional investor when considering moving into a new market region or making an allocation to a new private equity fund. For a potential limited partner (LP) still new to the asset class or to the sub-Saharan African market, the investigation and assessment process that precedes an investment is especially rigorous.

In Runa Alam's experience as co-founder of Development Partners International (DPI), potential investors might analyse the region for upwards of two to three years before searching for private equity partners. "In 2010, Africa was the fastest-growing continent in the world," she says. "A number of investors in Europe, the US and Asia started mapping the region at that time and slowly figuring out whether they wanted to be there."

Perhaps as a result of that build-up in interest, Alam noticed that the diligence around the region had changed in character in the 2013 to 2015 period, when DPI was raising its second fund. "If you went back 10 years, questions about corruption, stability and governance were much more common. Now it's much more grounded in what kind of companies do you invest in, what's your strategy, how do you exit?"



Runa Alam

She says, "Of course there are still questions about Africa-specific matters, but I wouldn't really say that there's a single big concern - more that it's part of a broader due diligence process."


"As with most African investment, key concerns encompass country-specific risks, political risk, currency volatility and

access to information," says Prasheen Singh, head of RisCura Consulting. The region's risk factors can vary widely from one year to the next and from one country to another, which makes taking a long view on these issues rather challenging. Understanding local risks and putting them in context with longer-term trends and developments is thus a critical part of the investment process.

Rory Ord, an executive at RisCura, says, "In our experience, LPs are concerned about track record, fees, valuations and the time commitment required by private equity."

"But depending on the type of LP, some or all of these will apply." For example, he says, "An American LP might be very comfortable with private equity, but may not be comfortable with the length of track record in South Africa. Defined contribution pension funds are very concerned about accurate and frequent valuations as they have to unitise their funds. African LPs often have geographical restrictions and many are not allowed to invest in private equity at all."

Similarly, when general partners (GPs) look to raise second or follow-on funds, their early successes can become an important indicator for LPs. Luc Albinski, managing partner of Vantage Mezzanine, says, "What certainly helps investors make up their minds is showing some early successful exits," which show the viability of the portfolio manager's strategy. These events also provide insight into the fund manager's valuation processes.




However, he cautions against focusing too much on early exits, particularly if that focus comes at the expense of other factors: "Early exits may not give investors insight into the overall returns of the funds -- many funds, whilst initially buoyed by early exits, are dragged down later."

Instead, he says, those early returns should be taken into account along with a broader due diligence programme.

That programme should involve more than strategy; LPs should also consider the fund's talent and depth of local knowledge. Singh notes, "When investors evaluate private equity fund managers they also consider the extent of on-the-ground expertise and access to investment markets." Indeed, in a region as diverse as the African continent, local knowledge and social capital can make or break an investment.

*"Local knowledge and social capital can make or break an investment."*

For Alam, setting up a team with local knowledge, experience, and language skill was a key priority. "Our team is from all over Africa and speaks all the business languages of Africa." Vantage has similarly filled its talent roster with an eye towards local talent. Albinski says, "An important principle has been the ability to build a team that covers some of the key African markets that we're targeting. Having someone local brings a lot of country knowledge, which is critical." 

### Would you invest in first-time managers?

**Lance Grayson**

**Investment Principal:** Old Mutual Private Equity

In the South African context, it is difficult to invest in first-time fund managers because, in many instances, they come out of the deal-making environment. That means that, whilst they are very capable at finding deals and even on doing deals, they are less experienced in taking an investment view. For people to have a good investment view, they need to have seen a large number of investments play out. So, there's an experience curve that is required -- someone with five to ten years' experience in private equity or proprietary investments, who is able to take those views. That's where most first-time fund managers fall down for us, in that they lack that particular capability. Some ways to overcome this are to establish strength within the investment committee, and perhaps hire independents and think differently about the investment approvals process.



Colin Rezek

## Putting mezzanine funding to work in Africa

*Africa's leading mezzanine debt provider, Vantage Capital, is in the final stages of closing its third mezzanine fund. Colin Rezek, co-managing partner at Vantage, tells SAVCA about life on the fundraising trail, and about the initial deals done from the new fund.*

**CR:** We issued the private placement memorandum (PPM) around July 2014. I think that the PPM drafting process was very efficient. Also, this is our third fund and I wouldn't say it was easy, but you learn more things as you progress. We went back to many investors to whom we had already been talking about previous funds and we managed to attract a number of new investors who are starting to see mezzanine as a credible and attractive asset class.

In Africa, we see commodities declining and as a consequence a shortage of dollars, and I think in this tumultuous environment investors tend to prefer safer havens. And I think they see mezzanine now as safer than private equity. Having said that, we've been doing it for 10 years now and we've realised that there's a great deal to learn about how to do mezzanine deals in Africa. We've learned over time how to structure deals and how to mitigate risks; and we're very happy that we've managed to raise a very decent size funding. We are in the final stages of closing the fund, with one investor to sign, which will take us to around R4 billion (\$250 million).

### So, have you exceeded your expectations?

**CR:** We were targeting R2.5 billion in total. But the rand has weakened since we said that, so we've actually exceeded our rand target substantially thanks to our dollar-denominated sub-fund. Overall, we're very happy with the result.



### What do you think of the overall fundraising environment?

**CR:** I think it's extremely difficult. Before the commodities collapse, Africa had a lot of shine to it. I think that shine has come off. We're seeing Angola, Mozambique and Nigeria feeling significant liquidity pressures. I think the growth rates in commodities-dependent countries are going to be under pressure. I think African governments are putting into place mechanisms to retain dollars in the economy, but that will cause currency devaluations and high interest rates. We see opportunities in North Africa; it's probably not the time yet for Egypt, but it's definitely settled and the economy is turning. I think we will have a few years of challenging times, so we're going to have to be smart in our choice of investment targets and prudent in the way we structure our deals.

*"We're going to have to be smart in our choice of investment targets and prudent in the way we structure our deals."*

But I think the prudent investors believe in Africa now and believe this is the time to come with us. I wouldn't say we were lucky, but with a track record and downside protection, we've been able to attract capital. I think, apart from the big guys or unless it's a niche product, it's going to be difficult for the lesser-known and first-time fund managers to raise capital.

### Can you touch more on the fund structure?

**CR:** We have a pocket for Southern Africa and a pocket for the rest of Africa. So we have two funds domiciled in South Africa, which is also the first time where South African authorities have allowed investors to invest US dollars in South Africa which are used for investments outside of South Africa. From our side it's very efficient as we don't need a Mauritian fund structure. We have one fund manager and two funds – one is a South African rand fund and another one is a US dollar fund. I think what's very unusual and attractive to investors in that they can choose which fund they want to be invested in and the extent of their rand and dollar exposure, by choosing an allocation between these geographically distinct funds.

We have investors who have wanted more exposure to the rand fund, and we have investors that have preferred the dollar fund. A number of the South African pension funds are looking for African exposure, and amidst all these challenging times in Africa, we do have some overseas investors who see this as an opportunity. We believe we can invest prudently at this bottom cycle and hopefully get them good returns. We have five years to invest and five years to disinvest, so hopefully by the time the cycle comes up again, that's the time we will be disinvesting.

### Do you see more appetite for your rand fund or for your dollar fund?

**CR:** We've been surprised at the amount of dollar interest, especially from the South African institutions. Based in South Africa, they may better appreciate the risks of investing in the rest of Africa. But I think they're going with us, because they think we can mitigate those risks. Also, in an environment of weakening currencies, if you can get a reasonable dollar return, then you can achieve a very good local currency return for these South African institutions.

### Are you offering the same sort of returns for both funds?

**CR:** I'd say the returns for the dollar fund will be slightly lower. So far we're achieving similar returns, but one must be realistic. We're seeing all the big private equity firms lowering their return expectations.

### Have you done any deals with Fund III?

**CR:** Yes, we've closed a deal in South Africa. We've invested in Servest [provided R356 million of funding]. It is a services group and their objective is to grow into Africa and they're also growing in the UK at the moment. We also have three deals approved by our committee – one of those in the property space in Lagos, Nigeria. We believe that high-end property in the right location will attract international corporates.

### How many deals are you planning to close this year?

**CR:** I'd always say that there must be pressure to do deals, but you must also be diligent not to do the wrong deals. There is always that trade off. With the deals that have been approved we envision doing four to five deals a year and in total doing around 20 deals across the entire fund.

### What's the appetite for private debt at the moment?

**CR:** Private debt has always been something that I have believed in. I think equity returns are under pressure. So if you can get people a decent debt return with much lower risk, I think there will be big appetite. We've seen the success of groups like Investec, which recently launched an African debt fund. And then you have Sanlam and Stanlib also looking at debt products across Africa. I think mezzanine is at the higher end of the risk scale; we're taking substantially more risk than the banks and you have certain investors who don't want to take that risk and they prefer to be in first lien senior debt funds. I think there will be growth in debt funds in Africa going forward [5](#)

# Scaling up

Fundraising is hard work. And although it might be difficult to raise your first fund from scratch, repeating it for a second fund has added complexities.

While institutional investors approached by first-time fund managers for funding are required to place much reliance on the capability of and chemistry amongst the team members at the manager, and on the coherence and viability of its proposed investment mandate, track record becomes ever more important as private equity managers move to subsequent funds.

Richard Flett, managing director and co-founder of Horizon Equity Partners, points to the problem that, because managers have to start raising a second fund three to five years after the launch of their first, there is an inherent problem in that these managers would typically not have a track record of realised investments when fundraising. At best, they would have exited one or two investments from their first fund.

## Establishing an exits track record

Hany Assaad, chief portfolio & risk officer and co-founder of Avanz Capital, a manager of private equity fund of funds that specialises in emerging and frontier markets, believes, however, that these restraints due to timing are known, and managers should plan some initial exits right from the start and balance the portfolio construction to include such early exits. From the perspective of being an investor in private equity funds, Assaad says that managers need to complete at least one – but preferably two – exits before commencing the fundraising for the subsequent fund.

“It is not just the exits that count but how well the fund manager plans and executes exits, taking into account portfolio construction and timing of the next fund raise.”

While any exit is useful for putting the proverbial ‘runs on the board’, Garth Willis, Director at Capitalworks, says “once you have talked the talk, an investor will want evidence that you have walked the walk before they are prepared to commit

capital to a fund”. They want to be able to “interrogate the real-life examples of a team’s actual investments in order to assess both the feasibility of the investment strategy as well as the team’s ability to execute that strategy on a repeatable basis”.



Garth Willis



Daniel Hatfield

It’s this repeatability that is key, especially when raising money in second and third funds – a point reiterated by Edge Growth managing director Daniel Hatfield. “Particularly when the mandate of your second fund differs from your first, the onus is on you to prove that your track record is still relevant and that the competence and experience of the team aligns to the scope of the new fund.”

Starting out and establishing a track record is tough. “The chicken and egg game that you have to play during the establishment phase is painful but necessary,” says Samantha Pokroy, CEO and founder of Sanari Capital.

“Investors would like to see deal flow and pipeline before committing capital to your fund. They want a look and feel of the investments you are going to make. They want to know that you can bring in the deals. So you start sourcing and progressing discussions with owners, management, and sellers. But then you get to a point where you need to move to a more serious intent and, without the committed capital, it is hard to do that!”

## Team talent

Pokroy maintains that “team construction is critical, particularly when you are a small start-up team and heavily reliant on each other. Long-standing relationships and open communication are key.”

Indeed, team composition and team dynamics are fundamental. Assaad says he would look for diverse teams with different expertise profiles and backgrounds. He insists that gender diversity is also critical.

Because Capitalworks is itself a business that is owner-managed, says Willis, it has a very strong cultural fit with many of the management teams that it looks to back. “Our investment philosophy is one of adding value to our portfolio companies beyond the capital invested and it is therefore important, in order for us to deliver on our vision for capital growth, to ensure that we attract talent that has a passion for commerce rather than solely being passive asset managers.”

Luc Albinski, managing partner at Vantage Mezzanine, says “experienced limited partners have told us that the primary reason for poor or very poor fund performance is a team melt-down often linked to the departure of key individuals. For many of the more seasoned LPs, a critical evaluation of the team dynamics constitutes a large part of the due diligence they perform on a fund manager.”

Nevertheless, fund raising remains “extremely disruptive” according to Flett. “Your best and most critical talent have to take time out from managing the portfolio and, generally speaking, the length of time it takes to raise funds has definitely been increasing over the past 15 years.”



Richard Flett



Luc Albinski



Photo: Nefio Media and Michelle Wastie Photography

Samantha Pokroy


*“Team construction is critical, particularly when you are a small start-up team and heavily reliant on each other.”*

## Strong conviction needed

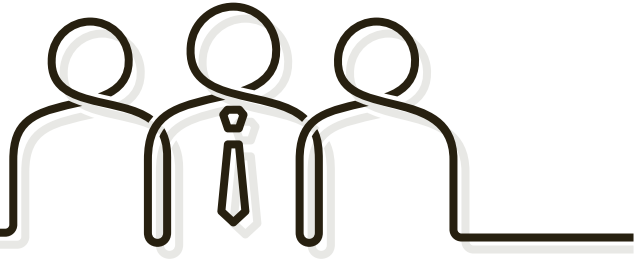
Pokroy, who is busy raising Sanari’s first fund, says she’s “experienced first-hand the demands of always being in sales mode. This is by definition exhausting and the only thing that sees you through the potentially hundreds of investor meetings or engagements is a deep passion and conviction about what it is you are selling.”

Horizon Equity’s Flett says some fund managers have been looking at alternative ways of raising money. “The most prominent example in the South African context was Brait’s decision not to raise another fund, but rather to raise capital through their listed management vehicle in 2011 as it transitioned to an investment holding company.

“More recently,” says Flett, “we’ve seen some managers starting out again turning to listed vehicles. The JSE in 2013 allowed the use of special purpose acquisition companies (SPACs) and this has gained some traction.”

“While fund managers in some cases are starting to look for alternative vehicles, that doesn’t mean that the traditional private equity partnership structure is going to die anytime soon.” Flett says. “It has so much acceptance, especially by international investors, that it still has a long life ahead of it.” 

# GPs GETTING AHEAD



There is enormous complexity to the process of moving from first-time private equity manager to being an established firm with multiple funds. Factoring in the requirements of investors who allocate capital into funds, together with putting in place a thriving team and implementing a disciplined investment process to manage that capital effectively, are some of the steps in ensuring a sustainable business model in private equity. SAVCA talks to **Hany Assaad**, co-founder and chief portfolio & risk officer at the emerging markets fund-of-funds manager Avanz Capital, to glean his advice for general partners (GPs).



Hany Assaad

**What is it that new managers need to know about the needs, expectations and requirements of limited partners (LPs), to ensure that the fund is successful and that the manager survives into a second fund?**

**HA:** When considering an investment into a subsequent fund of a private equity manager, LPs look for a number of factors that GPs need to demonstrate during the early life of the fund.

Some of these factors are:

- consistency in the application of the strategy of the fund
- the team is working well and team dynamics are demonstrated to be productive and efficient; the team is motivated and focused and there are no team disputes
- performance of the fund, with a demonstrated ability to build an executable pipeline
- attributable and demonstrated ability to add value to investee companies
- exit record is essential to demonstrate the ability of the fund manager to complete the cycle from company selection through due diligence and structuring to adding value to exit
- demonstrated application of safeguards from reputational issues, including a thorough integrity due diligence process with policies, processes and procedures applied rigorously for Combating the Financing of Terrorism, Anti-Money Laundering, and anti-bribery
- thorough and consistent management of environmental and social (E&S) risks and demonstrated value addition in E&S
- applied best practice fund administration, cash management and reporting.

**What are the critical success factors for ensuring that fund managers build a track record and are able to move to a second and consecutive funds?**

**HA:** The critical success factors include the completion of at least two exits (possibly one if it is the first fund) before commencing the fundraising for the subsequent fund.

This would require the manager to plan the early exists early on, and to balance the portfolio construction to include early exists.

Further, the fund manager would be required to demonstrate value addition that can clearly be attributed to its expertise and is recognised as such.

**How critical is the team construction and team dynamics and what do you look for in a team?**

**HA:** Team construction and team dynamics are critical for success and for future fundraising.

Essential elements for the team include:

- Diverse teams with different expertise (private equity, operational/consulting, financial, entrepreneurship, etc.), profiles and backgrounds. Gender diversity is also critical
- The well functioning of the team is also essential. Avoid an authoritative person who makes all the decisions: team involvement in the investment life cycle enhances the work of the fund manager. Avoid disputes and demonstrate that the team likes to work together in an open, frank and inclusive manner. [5](#)

# NEW FRONTIERS

While Southern African pension funds gradually are becoming more familiar with the private equity asset class, the take-up of this investment opportunity is still limited. The status quo is a challenge to the private equity industry to step up the quality of its communication with the pensions industry.

A key change for South Africa's pension industry occurred in 2011, when Regulation 28, which governs pension funds in South Africa, was amended to allow a greater allocation to alternative investments. The limitation on "other" asset classes (a grouping of alternative asset classes that includes private equity funds, hedge funds and other derivative or pooled vehicles) was increased from 2.5% to 15% of funds under management, of which 10% could be allocated to private equity, with a maximum allocation of 2.5% to any single investment or 5% to a fund of funds.

Take-up since then of private equity among Southern African pension funds has been slow. While a number of South Africa's largest pension funds are experienced investors into private equity funds, others have been hesitant to allocate to this alternative asset class.

Rory Ord, executive at RisCura, sees a positive move, though: "The trends we've seen over the last few years is that pension funds have started to become more comfortable with private equity as an asset class. The change to Regulation

28 specifically describing private equity as one of the asset classes that can be chosen by pension funds was the start of the process".

He adds that "there has been a great deal happening over the last number of years to get pension fund trustees more familiar with private equity as an asset class. And we've also seen larger allocations come from very large investors like the GEPPF and the Eskom Pension and Provident Fund, who have started to invest more widely into private equity, and to allocate more of their capital into private equity.



Rory Ord


Ord qualifies his observation, explaining that the process could be paced, and that "we still have some way to go before we get to a broader adoption from the pensions industry, into private equity".

One of the major reasons typically cited by pension funds for avoiding private equity is its illiquid characteristics, and the limits on the ability of the institutional investor to withdraw its allocation while in the holding period.

Nicole Paige, a partner at Webber Wentzel, explains that the liquidity issue is intimately wrapped up with the concern about what could happen over the holding period. "There is not much of a secondary market for pension fund interests in South Africa, so investors are generally locked in for a 10 to 12-year period," she says.

This is less of a constraint for defined benefit pension plans, which, because of their rules and structure, have "more ability for trustees to take a view on something like liquidity," according to Paul Boynton, CEO of Old Mutual Alternative Investments.

"Even within a defined contribution fund some level of illiquidity can be managed prudently," he says, "if the trustees are willing to pursue that opportunity in order to benefit from the returns uplift of private equity."

Boynton points out that the advantages of private equity extend beyond the returns boost that it provides to an institutional portfolio. "Importantly, there are also other objectives that can be met through the asset class. For example, prudentials around economic development, active ownership, and how environmental, social and governance issues can be driven in the private equity asset class need to be motivated. Private equity as a construct is particularly suited to these kinds of specific non-investment return objectives." 


## A pension fund investor in private equity

**Ndabe Mkhize** Acting Chief Investment Officer: Eskom Pension and Provident Fund (EPPF)

### What are you looking for in a private equity fund manager?

We are interested currently in managers focused in the mid-market space, especially where these managers use their skills set to capture the inefficiencies in pricing and deal sourcing in order to select good opportunities that can translate into attractive returns. A further element in our private equity strategy is to grow our investment portfolio into those African countries with healthy economic growth and scarcity of infrastructure. To this end we are looking for managers who have their feet on the ground in those markets, with track record in managing a fund or two. Our return requirement in markets outside of South Africa will be high, to compensate for the risk that we are taking. Further, we will pace ourselves in our broader African allocation, and will allocate capital where we see quality managers. Private equity is an ideal space within our total strategic asset allocation location and now that the regulation allows us to increase our percentage to much more than what it was in the past, we will – given our return assumptions and our risk budgets – be looking to scale our position in this asset class appropriately.

### What has your private equity performance been?

It's been a long track record, extending over 19 years – and we've seen good returns over those years. Looking at the performance over a ten-year period, which is appropriate for private equity, we believe that our returns on a net basis have been much better than what we've seen in the listed equity market. So it's an asset class into which we want to continue investing. 

# Perceptions of and allocations to private equity by Southern African pension funds

The Southern African pension funds industry has undergone significant growth in the past decade. In South Africa, the largest market in the region, pension assets are estimated to have nearly doubled between 2004 and 2014, to \$234 billion, according to a study of the global pension funds industry by Towers Watson. It found that the ten-year compound annual growth rate (CAGR) of industry assets was 5% for the period in dollar terms; when taken in rand terms, the growth rate is above 10%.

In tandem with this growth has come a wave of regulatory change in South and Southern Africa, which has begun to liberalise the ability of pension funds to invest in alternative assets, including private equity. Thus far, take-up of the private equity investment opportunity by pension funds in the region has been slow.

To research this issue, SAVCA conducted an anonymous online survey of the top 100 pension funds in South Africa and of the major pension funds in the Southern African Development Community (SADC) region beyond South Africa. This yielded some 39 completed surveys, representing 38 South African pension funds and one Namibian fund. Fourteen of the respondents have implemented a private equity programme, 23 indicated that they do not have a private equity programme, and two respondents did not specify whether they have a private equity allocation. None of the respondents has a venture capital allocation, with the exception of the Namibian respondent, which has a mandated exposure to venture capital and private equity.



Other important findings from the research, which was published by SAVCA in early 2016, include:

First, the majority of the surveyed pension fund managers employ asset consultants for certain support services. While the level of participation and influence of asset consultants vary considerably according to survey responses, it is clear that the role of advisors to the pensions industry is vital.

Second, defined contribution and standalone funds (the latter referring to those pension funds of a single employer, with an asset base of such an economic size that it does not need pooling with other pension funds) are less likely to allocate funds for private equity investment.

Third, while the majority of the small pension funds in our survey do not make allocations to private equity, there are some small pension funds which do invest in the asset class. Therefore, size is not a singular determinant of the appetite for private equity investment.

Fourth, pension funds with an existing private equity mandate and which are already invested into the asset class are the most likely to consider an increased allocation through new investment partnerships and are also more familiar with the process of private equity investment.

Fifth, the main impediments to private equity investment are liquidity concerns and limited familiarity with the asset class amongst pension fund managers, principal officers and trustees.

A key interpretation of the survey findings is the opportunity for private equity funds to focus on education, both for existing and potential pension fund investors into private equity – and for their advisors. [5](#)

# da LP Perspectives

**Paul Boynton**  
CEO: Old Mutual Alternative Investments

## What is your private equity investment mandate for 2016 and beyond?

**PB:** The mandate for Old Mutual Africa Private Equity Fund of Funds (AFOF) is to invest in a select group of portfolio funds with an African focus. The emphasis is on generalist funds which invest in later-stage development capital and buy-outs. Real estate and physical commodities are excluded. We prefer funds with a regional focus rather than country-specific funds, and those which allow us to participate in Africa's growth story. AFOF has a target of raising \$200 million to be invested over a total of three years; AFOF has so far committed to seven funds and typically invests between \$10 million and \$20 million in each fund.

## What are your views on the prevailing regional risks and opportunities?

**PB:** We take a "bottom-up" investor approach when assessing a fund, so current economic conditions don't have a significant impact on our investment thesis, although local fundamentals obviously affect the manager's ability to execute deals. We believe managers with the right skills can find attractive investment opportunities in current conditions, especially in consumer-related and export-orientated businesses. We look for managers who can manage cycles and the regional risks associated with declining commodity prices and the devaluation of local currencies. The economies of countries such as Nigeria and Angola, which have a strong reliance on commodities, are particularly at risk in the current cycle, while others feel the knock-on effects. We endeavour to select managers who invest in companies that have a natural currency hedge.

We focus on the long-term fundamentals and see the current economic environment as an opportunity for funds to acquire companies at attractive valuations. We also believe that Africa's longer-term prospects are underpinned by favourable demographics such as a growing middle class, urbanisation and strong GDP growth.




Paul Boynton

## Are there any new developments in your manager-selection criteria?

**PB:** We generally focus on entrepreneurial managers who have credibility, a good track record, and have good execution skills. Some more recent developments in our manager selection process have been driven by expanding our environmental, social and governance (ESG) processes and an emphasis on anti-corruption and bribery due diligences driven mostly by the UK, US and Europe.

## In your view, is there a sufficiently diverse spread of institutional-quality managers in the Southern African region?

**PB:** If we look at sub-Saharan Africa, private equity penetration is still minimal compared to developed private equity markets such as the US and UK (0.12% of GDP, compared with 1.23% in the US and 0.81% in the UK), though capital commitments are increasing. In addition, a number of sizeable funds, managed by some well-known international brands, have set up to invest in the sub-Saharan Africa market. We would like to see the number of institutional-quality funds increasing overall but particularly with regard to funds that focus on mid-market size companies. As the evolution of the African private equity market continues, we expect to see more mezzanine finance funds as well as more sector-focused and niche funds.

Asia is showing signs of running out of steam as the Chinese economy slows. Large managers are seeing Africa as an alternative, despite current commodity and currency problems. The industry is looking for more diversification such as smaller funds, mezzanine funds and more sector-focused funds. 



# PRIVATE EQUITY FUNDRAISING AND FUND LAUNCHES *Recent announcements*

Medu Capital closes Fund III  
// October 2015

IPDEV2 hits first close // 27 October 2015

STANLIB final closes infrastructure  
PE fund at R1.2bn // 26 January 2015

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commitments // 11 December 2015

Metier Capital Growth Fund II completes first  
close / February 2015

ARM-Harith Infrastructure Fund hits first  
close at \$91m // 16 February 2015

Development Partners International closes  
pan-African ADP II at \$725m // 1 April 2015

Business Partners unveils two SME property  
funds // 27 March 2015

Abraaj closes Africa Fund III at \$990m  
// 13 April 2015

IFC's FIG Fund gets \$345m at first close // 2 April 2015

Duet, Bouygues aim to raise \$200m for hotels  
development in SSA // 29 April 2015

Bamboo Financial Inclusion Fund II gets  
\$31m at final close // 28 April 2015

Impact fund agRIF hits first close at \$71m  
// 22 June 2015

Pembani Remgro Infrastructure Fund hits first  
close at \$245m // 19 May 2015

Momentum Africa Real Estate Fund gets  
\$150m after second close // 11 August 2015

Convergence hits final close at over \$200m  
for ICT infrastructure fund // 28 July 2015

Berkley hits final close for African energy  
fund // 23 September 2015

Business Partners launches R250m Women  
in Business Fund // 19 August 2015

ACTIAM-FMO SME Finance Fund reaches final  
close at over €150m // 8 October 2015

ACTIAM-FMO SME Finance Fund reaches final  
close at over €150m // 8 October 2015

Nisaba agriculture fund launched // 10 November 2015

CrossBoundary Energy Fund I reaches first  
close // 7 December 2015

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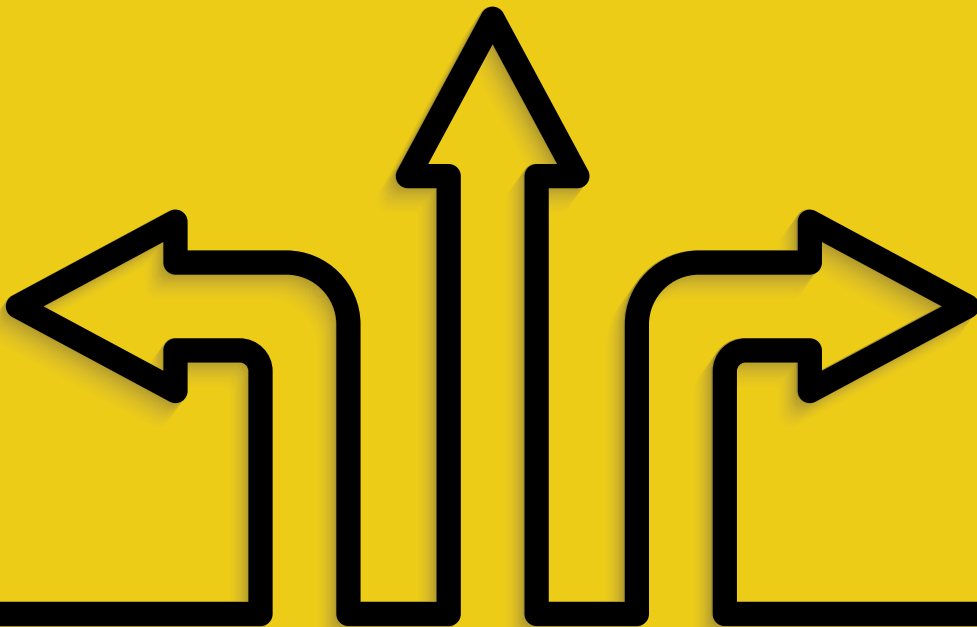


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**PRIVATE EQUITY | AFRICA**  
EVENTS

# Guiding the industry

*Locally and internationally, private equity is encountering ever-new waves of legislation and regulation that influence every facet of the industry. Craig Dreyer (Ethos Private Equity) and Richard Flett (Horizon Equity), both of whom serve on the SAVCA sub-committee for legal and regulatory matters, look back on the work done by the sub-committee in recent months. This work has included tracking some of these regulatory developments, assessing in which cases a collective industry response is required, and ensuring that SAVCA members are aware of legal and policy changes that affect their businesses.*



**SAVCA has done a great deal of work, since its inception in 1998, to represent the private equity and venture capital industry to various regulators and policymakers. What is your impression now, at the end of 2015, of the major trends and shifts seen in regulation of the financial sector, and of private equity in particular?**

**CD:** One's overall impression is that there has been a significant increase in the compliance burden for private equity in recent years, owing to the introduction of a range of new pieces of legislation and requirements for reporting, for business in general.

**RF:** We continue to see new legislation and regulations being proposed that are so broad as to capture private equity in their ambit even though this was not the original intention. Recent examples include the Davis Tax Committee's interim report on estate duty, and the proposed default investment portfolio regulations under the Pension Funds Act.

**SAVCA worked on various regulatory, legal and tax matters during 2015. What were some of the major developments over the period?**

**RF:** Members had their first round of reporting for FATCA this year, for residents and non-residents, with most funds likely to have submitted a nil report. SAVCA successfully lobbied SARS to provide a nil reporting channel that could be accessed by eFiling in a (relatively) simple fashion without needing an IT specialist. The industry has also been made aware of the imminent requirement for reporting under the Common Reporting Standards (CRS), which will extend the US-based FATCA reporting requirements on a worldwide scale. It will be a major challenge for private equity funds to comply with CRS, not just in terms of information content but also the third-party data channel that SARS insists must be used for filing reports. We expect most managers will have to turn to an outside service provider for this function, adding to their overhead costs.

**CD:** With regard to South African tax legislation, there has been engagement by SAVCA with National Treasury on sections 23N and 23M, which now are better understood within the industry. SAVCA has continued to request roll-over relief under section 23N, for interest not deducted within a given year. Separately, SAVCA engaged with National Treasury on section 12J, the portion of the Income Tax Act which governs the venture capital company regime; further proposals were made regarding changes that would render these incentives more workable.

Licensing by the FSB, under the FAIS Act, has been a further area of continued focus for SAVCA. The creation of a dedicated licence for private equity remains a work in progress, and we expect to have more to report in this regard during the coming year. And, on a different note, SAVCA made representation to the Financial Sector Charter (FSC) Council regarding the new FSC codes and their alignment with the generic DTI codes. These new codes, which are yet to be released, will have notable implications for private equity fund managers and their portfolio companies.



**What are the most likely regulatory, legal and tax developments for private equity in 2016?**

**RF:** We hope to get finalisation of a dedicated FAIS license category for private equity and with it perhaps some clarity on the Twin Peaks legislation, which is likely to usher in an era of expanded market conduct regulation and may possibly also lead to new regulation of private equity funds as well as their managers. Further, judging by proposed amendments to the FICA legislation which are out for comment, the compliance and reporting obligation under this regime will intensify, too.

The FSB published for comment proposed amendments to the Fit and Proper regime under the FAIS Act, which amend and expand existing requirements in respect of the operating capability of a Financial Services Provider (including solvency and liquidity). SAVCA is in discussion with the FSB on these amendments.

**CD:** Private equity fund managers should look out, also, for the outcomes from proposed changes to the taxation of trusts, as recommended during the course of this year by the Davis Tax Committee. SAVCA will monitor closely any developments relating to the taxation of trusts and, in particular, changes to the flow-through principles for trust beneficiaries. Also on SAVCA's radar for 2016 will be the outcome from industry feedback to National Treasury on its proposed Retirement Reform measures, which will have implications for private equity – and for all asset classes included into pension portfolios.

**RF:** Looking internationally, developments relating to AIFMD will remain of interest to SAVCA members planning on fundraising in Europe. Non-EU managers are currently required to register and comply with individual European countries' regulatory authorities, rather than having the benefit of a European-wide passport, and this regime looks set to continue for some time. If so, it is likely to make fundraising in the EU too risky and costly for smaller funds; even larger funds will probably want to concentrate their fundraising efforts on a small number of EU countries. [5](#)

# Women in Private Equity **WORKING TOWARDS CHANGE**

Madichaba Nhlumayo



Private equity is a people's industry, which advocates for diversity of insights and skills in its teams, in order to maximise the opportunity to deliver value for investors. And yet its board rooms and investment committee meetings have a low level of female representation. We talk to Madichaba Nhlumayo, an investment professional at Trinitas Private Equity, about this issue.

## **Why are there so few women in leadership roles in private equity?**

**MN:** I think it forms part of the broader question of why there are so few women in leadership roles in business globally. Research papers and books have been written by women and men across the world trying to answer that question.

Is it a lack of ambition to rise to the top or do we undersell ourselves relative to our male counterparts? Is it societal definitions of the roles of men and women in society or is it the guilt that suddenly engulfs us (but not our male counterparts) when we become parents? Is it work environments that may not sufficiently accommodate the flexibility required by parents, resulting in women opting out?

There is no simple answer. The fact is that women have the intellectual capacity, the drive and capability to lead in private equity.

## **Why is this an important issue for the industry?**

**MN:** In my opinion, it is important because we need to have diverse views in order to make good investment decisions. In a country where 51% of the population is female, having the insight of women around the table is critical.

## **How can private equity fund leaders address the gender imbalance in their own firms?**

**MN:** Our leaders can decide to prioritise hiring and mentoring women in their firms – not because it is a requirement of the transformation agenda in this country, but because it is critical to building good teams. Further, our leaders can decide to create enabling environments in which women who choose to have families can continue to thrive professionally and not have to make the choice between their career and their personal lives.

## **How do events like SAVCA's "Women in Private Equity" sessions benefit women in the industry?**

SAVCA hosts quarterly events for women in the industry. The genesis of these events was a discussion we had regarding the need for a networking platform for women in our industry. The events are a platform for women across the industry (LPs, GPs and advisors) to meet with a view to developing relationships. We generally have a successful woman as a keynote speaker and thereafter a networking drinks session. [50](#)

# PITCH YOUR THEME

## Private equity changes lives

**Name of investor:** FMO

**Investment theme:** Greening your portfolio

With oil prices at super-low levels, why bother about energy efficiency? Why bother with working on efficiencies in your portfolio when there are countless other priorities to work on? We need new CFOs, new equipment, we need fresh cash to pay our accounts. We challenge you to look at it from another perspective: making an investment in the efficiencies in your investees is the best bang for your buck. For many companies energy costs are a driving factor, and any decline in these substantial costs makes a CFO happy. And when buying new equipment, why not go for the more energy efficient one? It may be more expensive but have you calculated what the payback period is for that difference? Some further – indirect – benefits may be professionalism, lower fault rates, environmental benefits, reputational benefits or even staff retention. Private equity has a major role to play here and FMO is open for discussion to support you!

### GREENING



**Name of investor:** Africa Integras

**Investment theme:** Education

There is a tertiary education infrastructure crisis in Africa. Estimates suggest six million students are eligible to attend universities; however, there is insufficient infrastructure to accommodate them. To finance this infrastructure deficit will cost \$49 billion, of which governments, DFIs, and charitable institutions have pledged less than \$2 billion. There is a need to partner with the private sector.

In the context of the emerging world, education has the strongest impact on long-term economic development. For every incremental year of education, an individual earns 11% more annual income for life; a university degree enables a further increase of 3%. This increase translates into billions of dollars in additional tax revenues while also ensuring that graduates permanently transition from poverty into the middle class.

Our firm focuses on the basic bricks and mortar crisis. Africa Integras has established an investment model that provides affordable financing (on commercially attractive terms for investors) to African universities that struggle to address local demand for their seats. Our investments in the University of Ghana and Kenyatta University alone (combined \$117 million in capital) will translate into a minimum of 480 000 additional graduates over the next 35 years.

**Name of investor:** Capital Eye Investments

**Investment theme:** Technology

Technology can no longer be seen as a separate industry vertical. It's either a disrupter or enabler depending on the extent to which you decide to ignore or embrace the fundamental impact technology is having across industry.

Mobile phone penetration, for one, has created a new unparalleled level of consumer engagement. Across the African continent, 97% of consumers are forecast to access a mobile device by 2017. Consumer-facing organisations positioning to succeed will embrace this phenomenon when crafting appropriate customer engagement solutions.

Capital deployed through the private equity model has and will continue to provide an alternate asset class capable of enabling the deployment and adoption of new technologies.

These technologies (including the cloud, mobile devices and social engagement) enable the consumer to engage in a more convenient and cost-effective manner. The consequential social impact is profound.

### TECHNOLOGY



### EDUCATION



**Name of investor:** Alitheia Identity Managers  
(JV between Alitheia Capital and IDF Managers)  
**Investment theme:** Investing in high-growth SMEs  
with a focus on women

## WOMEN

High population growth in sub-Saharan African economies, coupled with a growing educated middle class, is fuelling a consumer boom and demand for goods and services, where women increasingly are controlling the household spending purse. African SMEs have grown exponentially over the past decade and account for up to 90% of all businesses. Growth is constrained by capital and expertise. Over 40% of the SME growth market is accounted for by businesses owned or led by women, funded through personal capital, family and friends, and that grow slower than those led by men, because they lack capital and confidence to venture into unknown markets. Women-led businesses are, however, 80% as profitable as the businesses owned by their male counterparts. By investing in women-led business, investors create a domino effect of raising incomes in the hands of women that is invested in better social, education and health within their communities and in economic growth in their countries and across Africa.



**Name of investor:** Makalani  
**Investment theme:** Empowerment

South African society remains characterised by racially based inequalities in income and social services, which are inhibiting the country's ability to achieve its full economic potential.

Broad-based black economic empowerment (BBBEE) aims to address the inequalities by mobilising the energy of all South Africans to contribute to sustained economic growth, development and social transformation.

The primary objective of Makalani Fund I was to be an enabler of empowerment transactions, which it successfully achieved. This has resulted in significant value accretion over the life of those BEE transactions. Where harnessed appropriately, participants in such BEE transactions have gone on to create investment platforms distinct from the original transaction. In addition, the beneficiaries of BEE Trusts have also enjoyed the social – particularly education and micro-enterprise – benefits arising from such empowerment.

It is our intention to replicate these successes in Makalani Fund II, particularly in so far as encouraging BEE investors to build sustainable businesses whilst realising commercial returns for investors into the fund. This will have the impact of changing lives for the better.



## EMPOWERMENT



## HOUSING

**Name of investor:** Phatisa  
**Investment theme:** Affordable middle-income housing

The Pan African Housing Fund (PAHF), managed by sector-focused African private equity fund manager Phatisa, provides risk capital to affordable housing and mixed-use projects in partnership with selected local developers across eastern and southern Africa.

One of the critical shortages facing sub-Saharan Africa is suitable shelter and housing. Through multinational equity funding, PAHF aims to actively address this growing and important need.

Phatisa is mandated to invest in six geographies, including the major urban areas of Kenya, Tanzania, Rwanda, Uganda, Mozambique and Zambia. To date, five investments have been made.

At the heart of Phatisa is development equity, a balanced blend of private equity and development finance. PAHF aims to build in excess of 7 500 homes, thereby providing access to shelter and sustainable communities to over 30 000 people, and intends to create an estimated 22 500 jobs in the countries it invests in, while delivering maximum return on investment to investors.

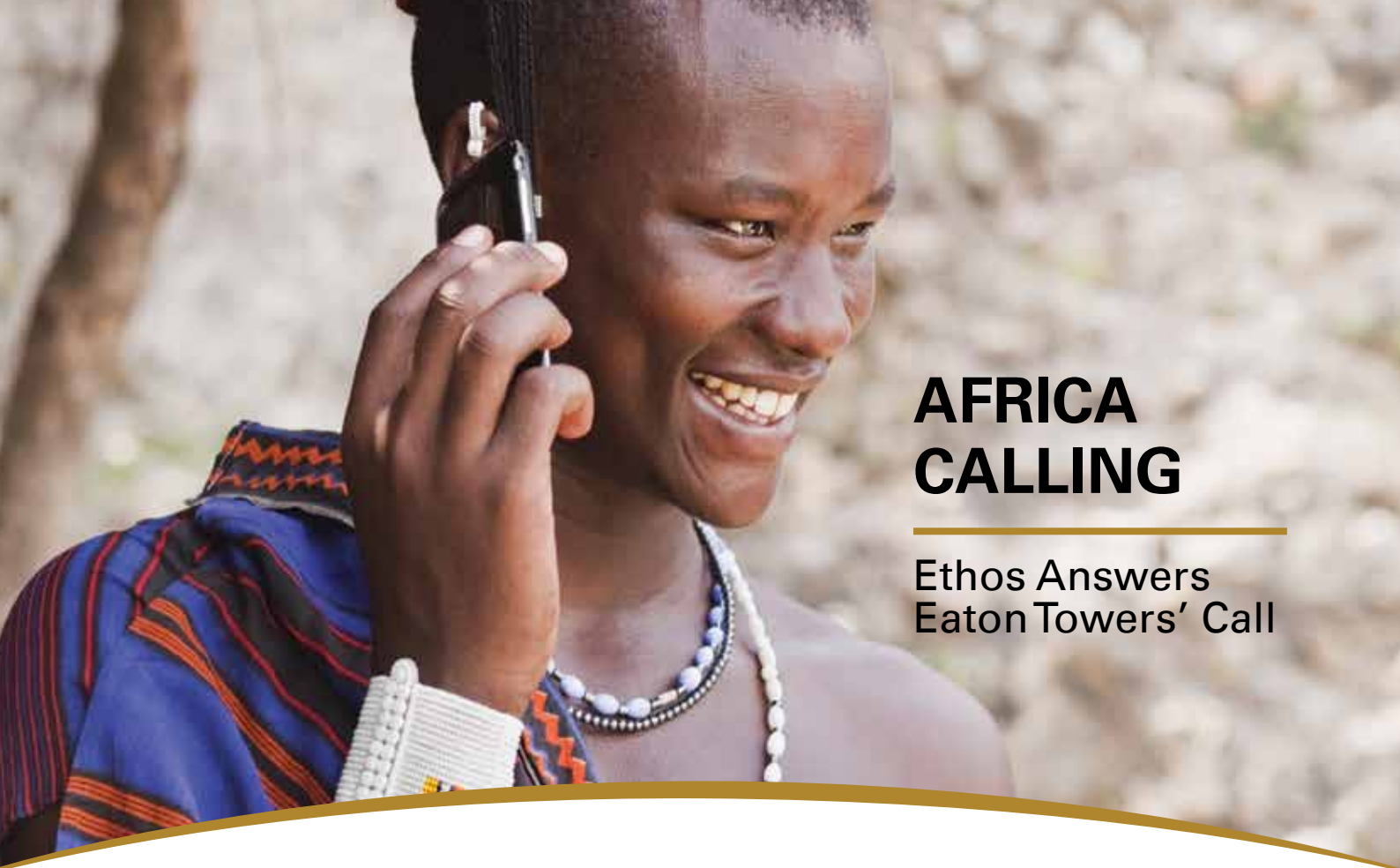
# Proudly championing private equity and venture capital



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.



# AFRICA CALLING

Ethos Answers  
Eaton Towers' Call

## E T H O S

P R I V A T E   E Q U I T Y

### Expanding horizons.

Local insights, regional networks and global reach.

Picture this.

You are standing on the banks of Lake Victoria – Africa's largest lake – eighty kilometres east of Kampala. Insects drone. A hippo breaks the water's surface and submerges again. Local fishermen cook the day's catch on open coals sending sparks dancing into the fiery sunset. A cell phone rings. And each fisherman reaches into his pocket!

This snapshot captures a picture of the abundant opportunity in Africa; teeming potential on the shores of economic evolution. While potential abounds, opportunities to invest in mature companies, of scale, that can grow across the continent by capturing the compelling consumer story are rare.

That's why when Eaton Towers – a leading pan-African, independent provider of shared telecom towers – required expansion capital we recognised a unique set of investment characteristics:

- a pan-African tower portfolio offering geographic diversity and reduced risk;
- a scarce consumer-facing, strategic asset;
- a proven value proposition for consumers and mobile network operators; and
- alignment with likeminded, private equity shareholders.

We are delighted to be partnering with management, existing and new shareholders in this pan-African transaction. Moreover, we are excited to have collaborated with two Ethos Fund VI investors to contribute US\$150m of the US\$350m new equity raised to realise Eaton's vision of becoming the most geographically diversified tower company on the African continent.


Now, back to Lake Victoria.

Reach for your cell phone, snap that picture and – thanks to Eaton's towers – post it on your profile with the status update: Wish You Were Here!

[www.ethos.co.za](http://www.ethos.co.za)

**BUILDING BETTER BUSINESSES**

Ethos is an Authorised Financial Services Provider

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**EatonTowers**