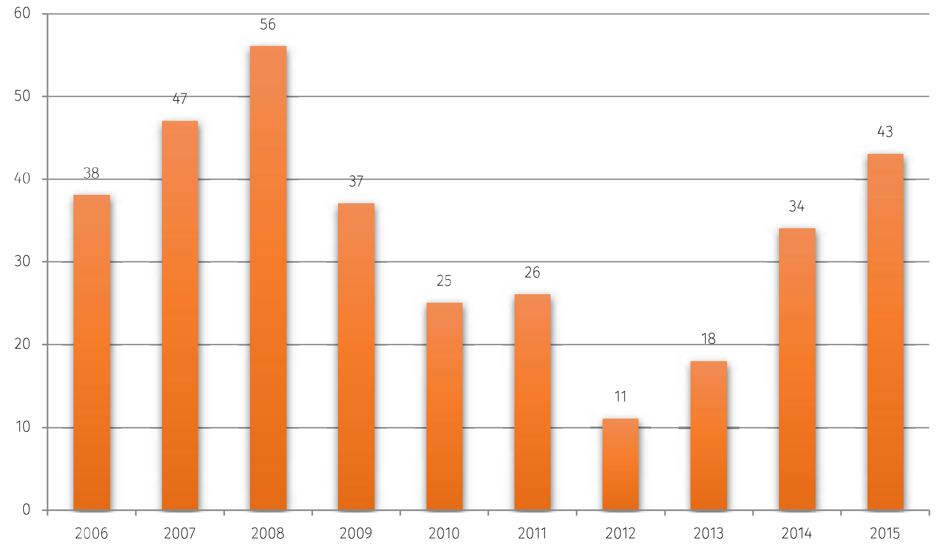
South African Venture Capital

The South African Venture Capital (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 R865m. As at July 2015, total VC assets under management were valued at R1.87bn, comprising 187 deals.

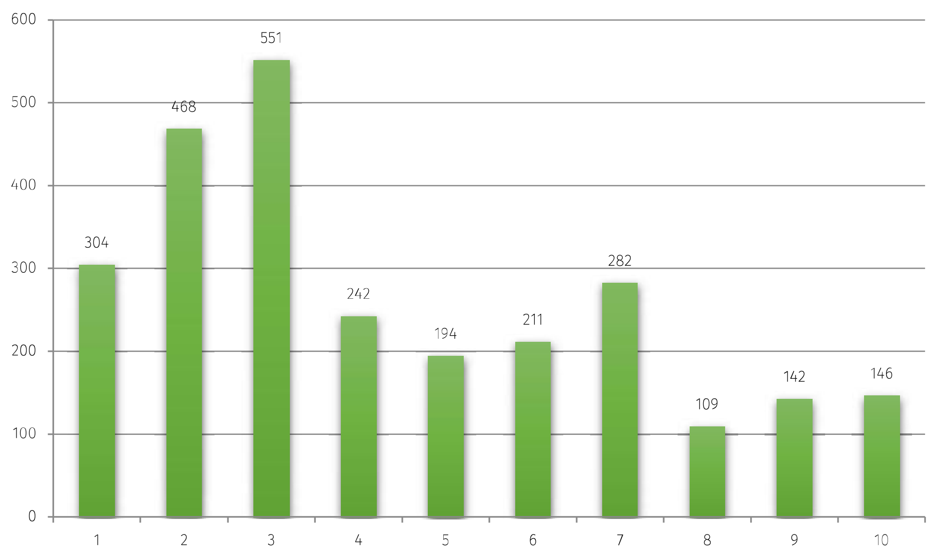
TOTAL NUMBER OF TRANSACTIONS PER YEAR



Source: SAVCA (Figures for 2015 have been annualised)

"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.

TOTAL VALUE OF TRANSACTIONS PER YEAR (R,m)

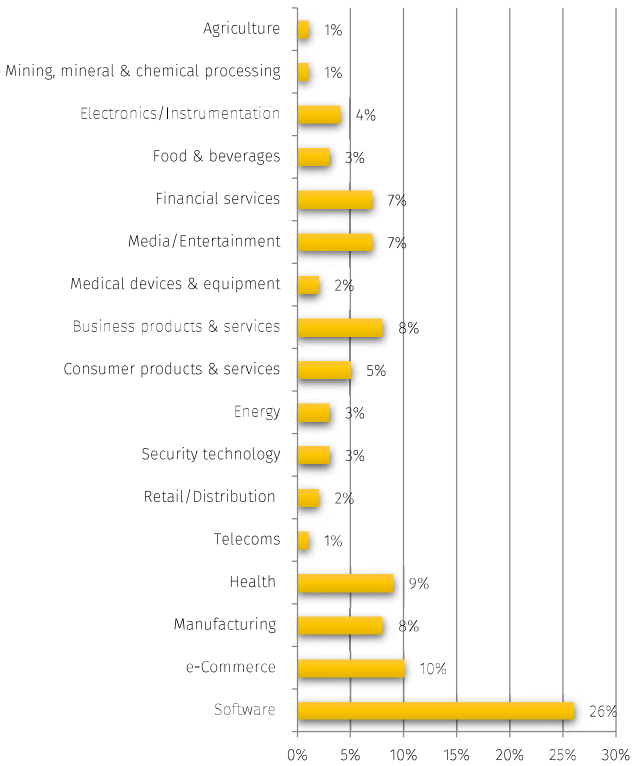


Source: SAVCA (Figures for 2015 have been annualised)

DEAL FLOW ACTIVITY

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 annualized in 2015 to date. In line with international trends, the average deal size has declined in recent years: The average transaction

VOLUME OF DEALS BY INDUSTRY SECTOR IN 2015



Source: SAVCA

value has reduced from R9.3m over the 2009-2012 period, to R7.3m 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.

The largest number of deals came from ICT-type sectors that include software (26%), e-commerce (10%), electronics (4%) and media/entertainment (7%), together accounting for almost half of all deals reported. 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.

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 R42.55m (5% of total value of deals).

Government-backed investors still represent a significant portion of the value of investment activity, given the magnitude of deals done by such investors. However, the survey shows that private sector fund managers collectively now have overtaken government as the primary source for VC-type deals, even more so when considering the number of deals: more than 81% of deals recorded in the survey period represented private sector fund managers.

EXIT 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 R187m, compared with the total value of profitable exits of R438m.

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.

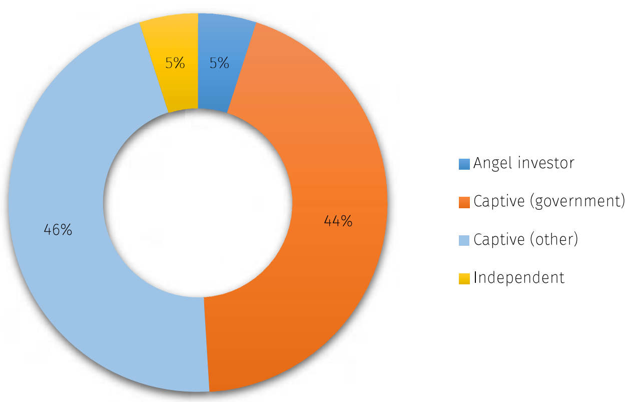
There are relatively healthy confidence levels in the VC sector, with two thirds of respondents reporting that they anticipated a profitable exit in the next 12 months, with profitability expectations ranging between two and five times money back. In view of the current economic climate, almost all respondents indicate a willingness to wait up to three years for a profitable exit.

"The 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.

Findings from the survey that public-sector VC funds are reducing their activity is a concern, though, says Stephan Lamprecht from Venture Solutions, who conducted the survey. He 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," he adds.

VALUE OF DEALS BY FUND TYPE



Source: SAVCA