LP Perspectives

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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 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.

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."

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."