# RisCura - SAVCA South African Private Equity Performance Report

*As at 31 March 2016*

SAVCA
SOUTHERN AFRICAN VENTURE CAPITAL AND PRIVATE EQUITY ASSOCIATION

RISCURA

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# 01. Foreword

**July 2016**

We are pleased to release the March 2016 edition of the RisCura - SAVCA South African Private Equity Performance Report. This report tracks the performance of a representative basket of South African private equity funds and is published quarterly. The purpose of the report is to provide stakeholders in South African private equity with insight into industry returns, and to establish and maintain an authoritative benchmark for the measurement of private equity performance in this market. Since its inception in September 2010, this report has become a vital component in the marketing of the private equity industry. We would like to thank SAVCA members for making their performance data available, and for their commitment to this project.

**Heleen Goussard**
*Executive: RisCura*

**Erika van der Merwe**
*Chief Executive Officer: SAVCA*

# 02. Market commentary

The first quarter of 2016 has seen more of the same of the woes that plagued 2015; an unpredictable exchange rate, increasing inflation and interest rates, political uncertainty and droughts, to name but some. We see the effects on gross domestic product (GDP) and the consumer alike, as a sharp contraction in mining, off an already low base, tipped economic growth into negative territory in the first quarter of 2016 contributing to South Africa's economy shrinking by 1.2%.

The impact of low rainfall continued to plague agriculture as the industry recorded its fifth consecutive quarter of negative growth, while the transport industry recorded its second consecutive quarter-on-quarter fall in activity, joining agriculture in recession territory. Demand for goods and services declined for all components of expenditure on gross domestic product (GDPe) with the exception of government consumption expenditure. Exports of goods and services were the most significant contributor to the overall decline. The unemployment rate in South Africa increased to 26.7% in the three months to March of 2016, the highest reading since September 2005. Ratings agencies maintained the nation's credit rating at BBB, whilst warning it could cut South Africa's debt to non-investment grade if the economy doesn't improve or if institutions are weakened by political interference. Business confidence fell to its lowest level in almost 23 years and GDP this year will probably grow at the slowest pace since the 2009 recession, according to forecasts.

However with all the dire economic news around, Private Equity remains a source for positive news and resilience. As evidenced by this quarters returns of 14.6%, 14.9% and 19.0% for the 3-year, 5-year and 10-year periods respectively, with both the 5-year and 10-year returns up from last quarter's 15.2%, 14.8% and 18.5% for the same time comparatives.

The just released SAVCA 2016 Private Equity Survey shows more of the same improvements. Funds under management grew by R15 billion in 2015 (equating to a compound annual growth rate of 12% since 1999 when the survey first begun). 2015 also heralded a great year for fund raising, indicating the favourable reputation the industry holds with R29 billion raised in 2015 compared to only R11.8 billion in 2014. It further evidences the positive impact of private equity on GDP as investment activity for independent funds was 0.2% of GDP as compared to 0.1% in the prior period. The industry assisted in adding liquidity to the market as funds returned to investors totalled R8.9 billion whilst further investing a R10.5 billion in new investments. Managers see encouraging prospects in the medium term as evidenced by the moderate uptick in valuation of unrealised investments increased to 1.17x from 1.16x in 2014. Private Equity further did its bit for employment by increasing the professionals employed to 489 (from 467) and made strides in improving diversity through the increased participation of female and black professionals.

# 02. Market commentary cont

The South African Private Equity industry remains sector agnostic, investing largely in all sectors to the betterment of the economy. With uncertainty prevailing in the global economy, industry selection has become even more crucial as managers focus on capital preservation and enhancing returns. For those investing outside of South Africa, the infrastructure gap in Africa remains large. Africa Infrastructure Investment Managers regional director, Vuyo Ntoi, has called for deregulation to allow private owners to become the facilitators of infrastructure provision. Ntoi praised South Africa, suggesting regulators could emulate the model used to facilitate South Africa's renewable energy programme as well as the South African toll road programme that opened three major routes to the private sector in the 1990s.

South Africa is a centre focus for global investors, in particular Private Equity, as the country is seen as the top destination for green-power investments across the continent and the Middle East. These investments are not only easing electricity supply constraints and providing "clean" power, but are also earning returns greater than those in bonds and the listed market, as I'm sure our own Managers can attest to. The Renewable Energy Independent Power Producer Procurement Program has secured about $12.5 billion in investments since 2011 and is touted to attract another $35 billion by 2020.

Whilst the local Private Equity market has certainly increased in competition, if the number of auction processes we have seen and the expanding number of those bidding for these assets is anything to go on, it is an active one. The secondary market is booming, with many Private Equity held assets coming to the market as fund's lives come to an end. I remain positive that the political landscape will settle with the upcoming local elections and the economy will eventually turn. In the meanwhile, Private Equity continues to be a safe harbour and its ability to find excellent returns during tough times is an inspiration.

**Annabelle Satterly**
*Medu Capital*

# 03. Private equity in South Africa

Private equity is an asset class which differs in nature from most other assets, including listed equity. Typically, private equity fund investments show low correlation to quoted equity markets and are relatively illiquid, particularly in the early years.

Private equity will normally show a drop in net asset value before showing any significant gains. This is often the effect of management fees and start-up costs on the relatively small capital base of a new fund. Private equity funds in South Africa typically follow a commitment and draw-down model, which means that investors commit a certain total of capital at the start of a fund, but are only requested to transfer cash to the private equity manager as investments are identified or costs are incurred. These funds typically return capital during the course of the fund's life as investments are realised.

South African private equity offers institutional investors the opportunity to invest in an asset class which has historically outperformed listed equity over the long term. It does, however, have a different nature from quoted equity and it is crucial that an institutional investor considers the appropriateness of private equity to its particular objectives.

# 04. Methodology

**Methods of measuring performance**

The most widely accepted method for calculating returns of private equity funds is the annualised internal rate of return (IRR) achieved over a period of time. As a sense check to the IRR measure, we also use the Times Money performance measure. This report measures performance in two ways: by 'since inception' and 'end-to-end' (over three, five and ten years). The IRR calculated in this report is net of fees over all periods.

**IRR Since inception**

This is the most widely used IRR measure of private equity performance. It measures the return of PE funds based on all cash flows in and out of the fund, as well as the remaining net asset value of the fund. This therefore most closely reflects the return an investor would achieve if they invested at the start of the fund. This is the most likely scenario in South Africa where investors in private equity funds are locked in for the life of the fund, and must catch up initial fees when joining a fund after the initial investors.

**End-to-end IRR**

End-to-end IRRs allow the computation of the return of groups of private equity funds which do not necessarily have the same inception date. This calculation also allows a better comparison of private equity returns to those of other asset classes over similar periods. While this method has advantages, it must be noted that it allows the returns of funds at different life cycle stages to be combined. Where the period selected contains more new funds than older funds, the return will likely include a higher balance of fees than a time period with more older funds. The longer term IRRs are considered to be the most indicative of private equity performance across different stages of the economic cycle, and are considered to be the headline measures. Shorter term returns should be viewed with caution as private equity is a long term investment. However, shorter period returns may be indicative of the general performance of private equity over this short period.

**Times Money**

Times Money is the ratio of total capital invested to total capital returned and remaining value. This is a useful cross-check of IRR measures, and is easily understandable. While IRR calculations are heavily dependent on the length of time that capital has been invested, Times Money does not take time into account. A Times Money in excess of 1 means that value has been created for the investor.

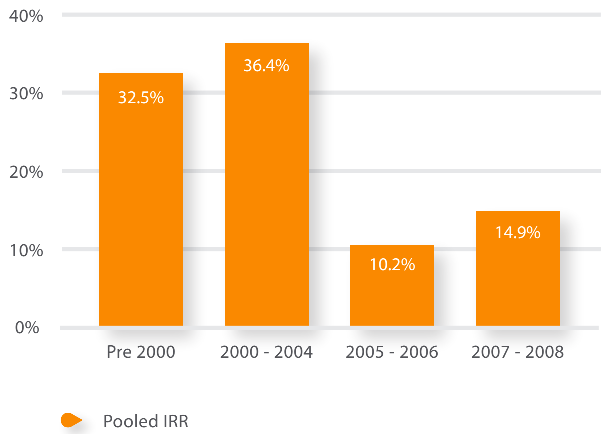
**Public market equivalent (PME)**

This measure seeks to equate the heavily timing-dependent returns of private equity funds with the returns of public market indices. The measure is a ratio of the net outflows from PE funds re-invested into the public index to the end of the fund's life, divided by the inflows into a PE fund invested in the public index until the end of the fund's life. A ratio of above 1 reflects outperformance of private equity, while a ratio under 1 reflects under performance.

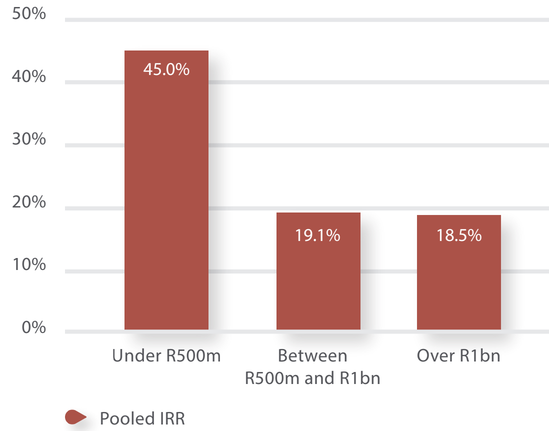
# 05. Performance in South African Rands

### Pooled IRR by time period

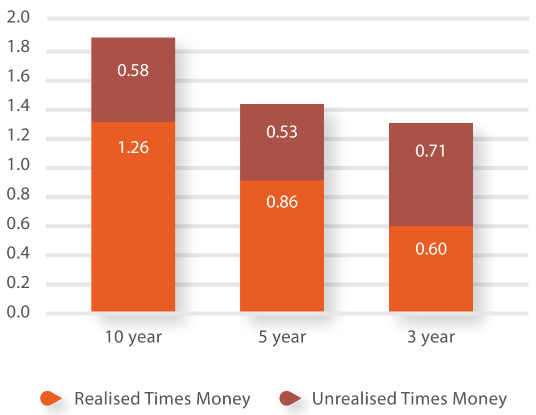

### Pooled IRR by vintage year



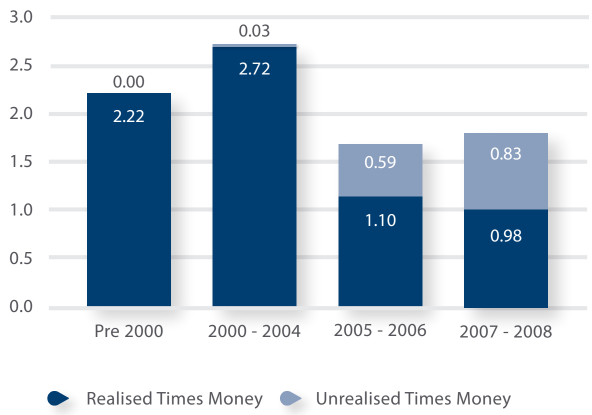

### Pooled IRR by fund size



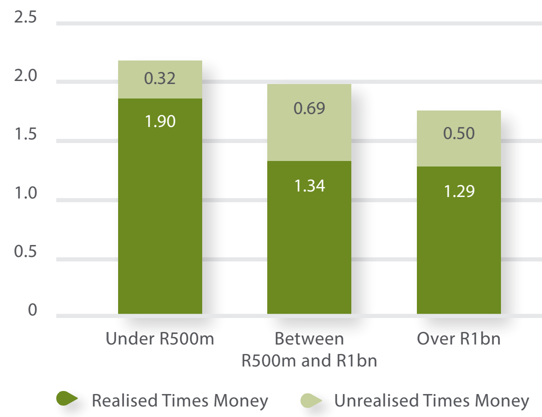

### Times Money by time period




### Times Money by vintage year



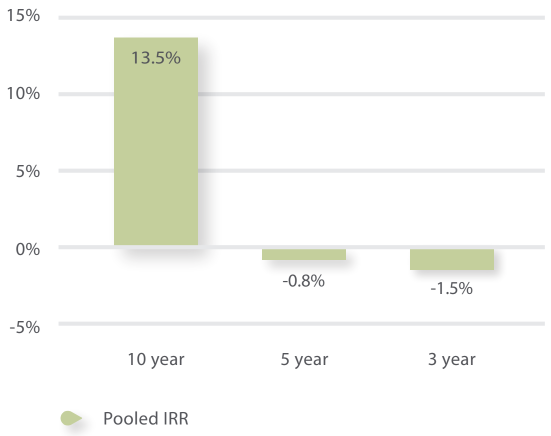

### Times Money by fund size



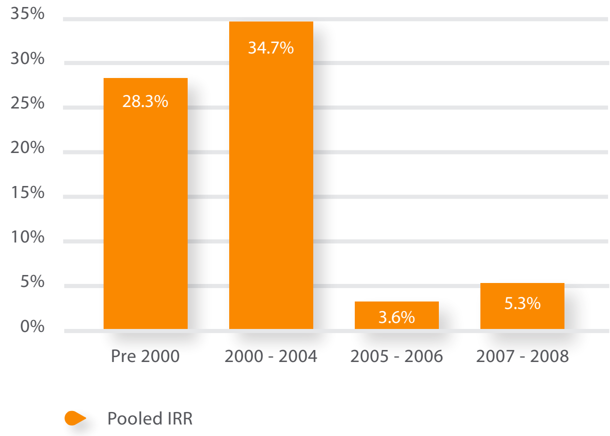

*Fund Size is reflected as committed capital in South African Rands.

# 06. Performance in US Dollars

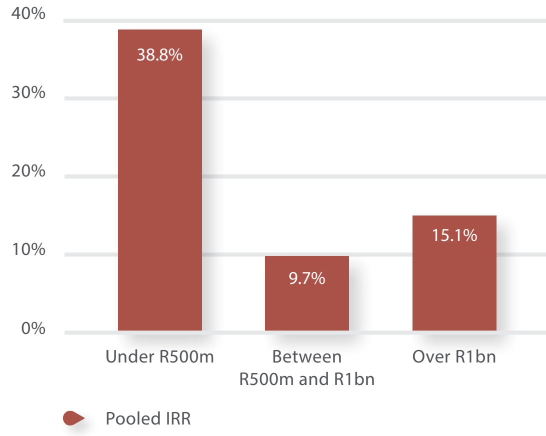
### Pooled IRR by time period



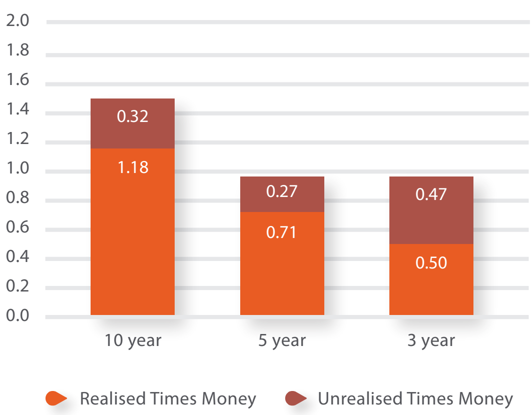

### Pooled IRR by vintage year



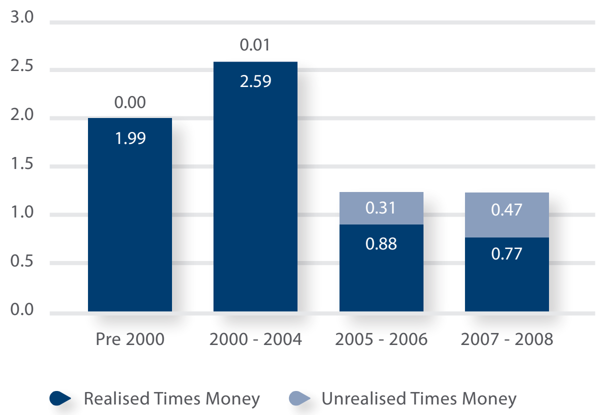

### Pooled IRR by fund size



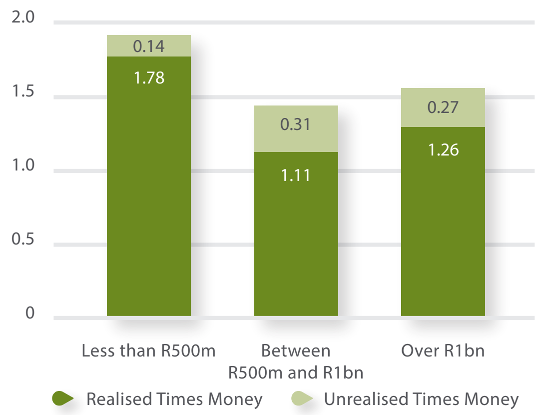

### Times Money by time period




### Times Money by vintage year




### Times Money by fund size




*Fund Size is reflected as committed capital in South African Rands.

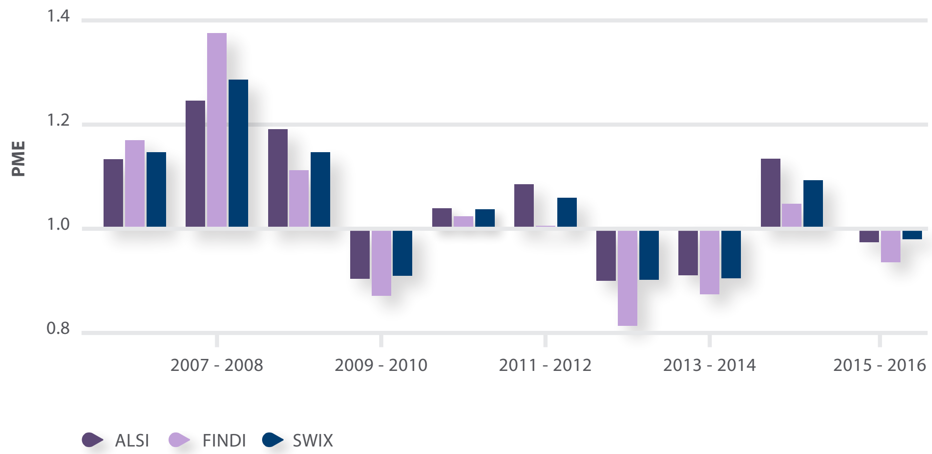
# 07. Listed equity comparison (ZAR)

### CAGR

| Time period | Pooled IRR | ALSI TRI* | FINDI TRI* | SWIX TRI* |
|---|---|---|---|---|
| 2006Q1 - 2016Q1 | 19.0% | 13.1% | 17.6% | 13.8% |
| 2011Q1 - 2016Q1 | 14.9% | 13.6% | 23.3% | 15.4% |
| 2013Q1 - 2016Q1 | 14.6% | 12.8% | 20.1% | 14.6% |

*Listed index returns are before fees.

### Performance compared to listed equity markets

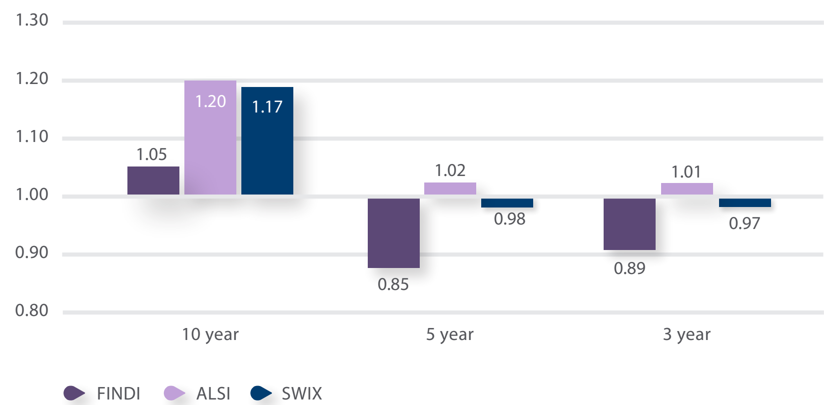



### Public Market Equivalent**

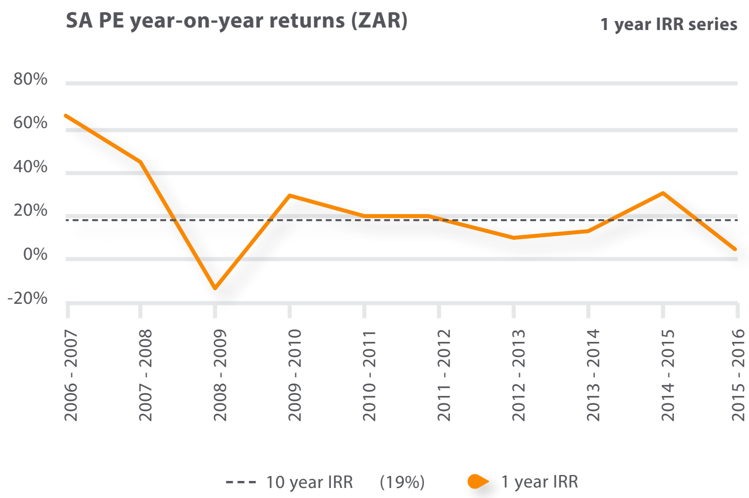
| Time period | PME FINDI | PME ALSI | PME SWIX |
|---|---|---|---|
| 10 year | 1.05 | 1.20 | 1.17 |
| 5 year | 0.85 | 1.02 | 0.98 |
| 3 year | 0.89 | 1.01 | 0.97 |

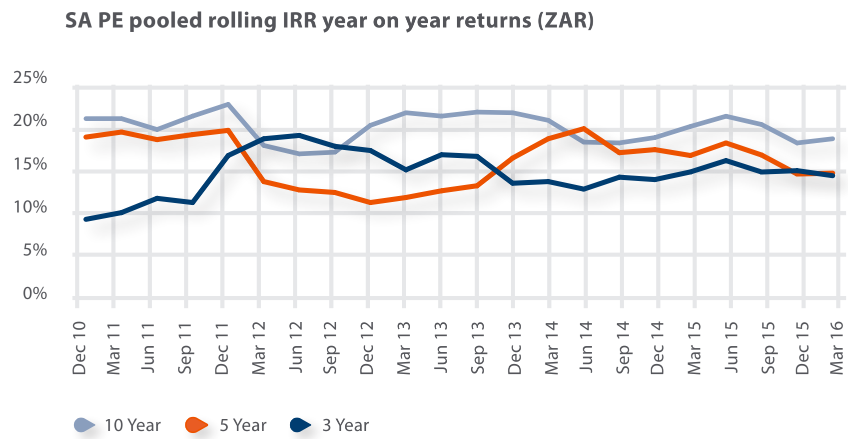
**Listed indices used in the computations are total return indices before fees.

### Public market equivalent results by time period



# 08. Private equity returns over time



# 09. How to use this report

## Useful information:

Returns of cash flow and portfolio value data from private equity managers are the primary source for information included in this Report.

The IRR performance calculation solves for the discount rate that makes the Net Present Value of a set of cash flows equal to zero. The calculation is based on cash-on-cash returns over equal periods, modified for the residual value of the fund's equity (NAV). The residual value attributed to each respective group being measured is incorporated as its ending value.

The database accounts for cash flows on a daily basis wherever possible otherwise a monthly basis, and NAVs on a quarterly basis.

The End-to-End performance calculation is similar to the since inception IRR, however, it is measuring the return between two points in time. The calculation takes into account the opening NAV, the in-period cash flows and the closing NAV. Returns are then annualised for comparability.

The pool of funds has been split into subsets where this would enhance the user's understanding of returns. However, this has been balanced with confidentiality considerations, and no such subsets include fewer than four funds.

Most funds included in this Report have unrealised investments, and therefore rely on the valuation of these investments to determine returns. All participating fund managers are members of SAVCA and apply the International Private Equity and Venture Capital Valuation Guidelines to determine these valuations. RisCura has not verified that these Guidelines have been adhered to.

Only South African Rand denominated funds have been included in this Report, and therefore none of the returns included are affected by exchange rate movements.

## Definitions:

**CAGR** is the compound annual growth rate.

**Committed capital** is the value of dedicated investment funds pledged by the investors of a private equity fund and available for investment. This is a proxy for the size of the fund.

**Fund Size** is determined by the committed capital of a fund.

**IRRs** are money-weighted returns that should be compared to time-weighted returns with caution. Time-weighted returns are used to measure returns in most asset classes where frequent valuations are available.

**PME** Public Market Equivalent is a measure that determines whether private equity returns have exceeded or underperformed a public market. A PME score of more than one indicates outperformance of private equity.

**Pooled IRR** aggregates or "pools" all cash flows and ending NAVs to calculate a money-weighted return.

**Realised Times Money** is the ratio of cash returned to investors divided by total cash invested.

**Total Times Money** is the sum of the Realised and Unrealised Times Money.

**Unrealised Times Money** is the ratio of the carrying value of portfolio investments not yet returned to investors divided by total cash invested.

**Vintage Year** is defined as the year in which a fund first draws down capital from its investors.

# 10. About

## About RisCura

RisCura is a global, independent provider of professional investment services. RisCura services institutional investors, asset managers, hedge funds and private equity firms with over USD200 billion in assets under advice. RisCura is a leading provider of investment consulting, independent valuation, risk and performance analysis services to investors.

**For more information about RisCura visit www.riscura.com**

## About SAVCA

The Southern African Venture Capital and Private Equity Association (SAVCA) is the industry body and public policy advocate for private equity and venture capital in Southern Africa, representing about R165 billion in assets under management, through 150 members. SAVCA promotes Southern Africa private equity by engaging with regulators and legislators on a range of matters affecting the industry, providing relevant and insightful research on aspects of the industry, offering training on private equity and creating meaningful networking opportunities for industry players.

**For more information visit www.savca.co.za**

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