

A journal of activity and trends in Southern African private equity 2018



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savvy

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Adjective

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 - perceptive and well-informed
 - keeping abreast of the latest trends
 - following the subjects relevant to you
 - having access to over 20,000 white papers
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The theme **"20/20: Hindsight. Insight. Foresight."** commemorates SAVCA's 20 years in existence, and will set the tone for SAVCA's activities in 2018. Throughout this journal and over the next 12 months, we will explore "Hindsight", which is the ability to reflect and learn from the past, "Insight", the ability to interpret and respond to the present, and lastly "Foresight", the ability to predict and prepare for the future.

In this journal, you will see articles, interviews, thought leadership pieces and excerpts in which we reflect on how the private equity industry has changed over the years and the lessons we can learn. We investigate the current state of the private equity industry through an analysis of fund raising, deal flow and exit trends, including regulatory matters affecting the industry. Lastly, we feature expert commentary on potential future trends that might impact the industry and how best to respond to them.

We are also excited to share the story of SAVCA's humble beginnings and how, through the camaraderie of the members and the appointment of a full-time executive, SAVCA has grown into an association that has made a major impact on the industry and continues to be a force for good.

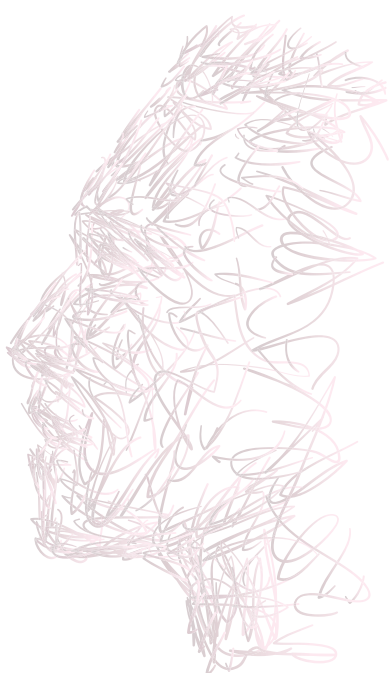
SAVCA's goal for 2018 is to continue to harness its momentum as a champion of the private equity and venture capital industry in Southern Africa. Our initiatives this year will be geared towards achieving this goal as we reflect on lessons learnt as an association and prepare for the future to ensure we achieve our strategic objectives of promoting the asset class, advocacy, playing a role in the transformation of the industry and ramping up our venture capital activities.

We want to thank our members and all those who have contributed to this journal. We always enjoy working with our members who freely share their knowledge and experience for the benefit of the industry. This speaks to the collegiality of the sector, which I've come to know and grow proud of in my first year as CEO of SAVCA.

Thank you for celebrating 20 years of SAVCA with us! 

Tanya van Lill

CEO: SAVCA



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Achieving 20/20 Vision Hindsight. Insight. Foresight.

Chairman's note



Yesterday...

It really does feel like yesterday when I first sat down in Jo Schwenke's (Business Partners) office amongst sector peers and colleagues (having coffee) discussing the notion of creating a unified voice and policy advocate for the private equity industry, especially when it came to engaging with regulators. Shortly thereafter, thanks to this motivated group, the Southern African Venture Capital and Private Equity Association (SAVCA) was established. Twenty years later, I find myself Chairman of a Board of talented, skilled and experienced experts and at the helm of an organisation that has made great strides in promoting these asset classes across the region. Back in 1998, private equity was virtually unknown, especially amongst the pension fund industry, which meant that education had to be an overarching aim, as would expanding our membership base.

In order to enhance our value proposition, we launched our first annual survey shortly after (about 5-6 pages only), which provided some background to the industry and information about the assets under administration. The next publication was a simplified form of the member's handbook, which was inserted into one of the leading financial publications at the time. This was followed by our inaugural foundation programme, paving the way for the establishment of a number of training programmes within the sector; showcasing our credibility not only as a representative for the industry but also as a partner and advisor to our members. These initiatives allowed for extended reach and increased membership and also helped create the vision for the SAVCA we see today.

Today...

Every time I visit the SAVCA offices I'm astonished at the milestones we have achieved over the past two decades, something we would never have envisioned all those years ago. We currently represent over 160 members across Southern Africa, with more than R 170 billion in assets under management. We have strong partnerships with key stakeholders as well as a remarkable Board and executive team, complemented by the appointment of a formidable, new CEO – who I know will lead us forward into many more successes. Over the years, we have also shaped and influenced ongoing policy-making and legislation impacting the sector.

Tomorrow...


As much as we would all like a crystal ball, as industry players we cannot always predict what the future holds. Of what I am certain is, the industry as a collective, is resilient and agile enough to withstand any shifting market forces. Of course, there is no doubt that risk mitigation and planning will form a key component of ongoing sector strategy formulation. The trend of borderless African private equity funds will be ongoing, characterised by increased continental deal flow and more companies operating across multiple jurisdictions.

What's more, private equity will continue to drive measurable improvements in corporate governance, employment equity initiatives, skills programmes and environmental stewardship through enhanced portfolio compliance as well as impact investment (which is set to increase with more development finance institutions (DFIs) investments coming into Africa).

Alternative fund raising models are also making headway. For instance special acquisition companies (SPACs), which provides a quick way of raising capital. The introduction of the Section 12J tax incentive has, to date, already assisted in the increase of capital for investment in appropriate businesses.

In emerging markets, we are also seeing the rise of permanent fund vehicles (which allow for a fund life longer than 10 years) which can serve as an alternative fund structure. And more recently an interest in Crowdfunding models. Rest assured, that SAVCA will continue to keep abreast of these ongoing trends, ensuring that it is able to provide members with accurate insights into the potential opportunities and corresponding risks of each emerging model.

Furthermore, as an organisation, our focus will be placed on transformation, especially in terms of fund manager outreach and across portfolio companies. The promotion of venture capital (which recorded a 134% increase in the value of investments in 2016 alone) is high on our agenda, with a number of initiatives in the pipeline to create awareness about the asset class, foster entrepreneurial spirit, connect businesses with investors and ultimately contribute to employment and sustainable GDP growth.

I am confident that we are on the right track towards another successful 20 years... and beyond. 

Craig Dreyer

SAVCA Chairman



HINDSIGHT



SAVCA: Two decades of advocacy

SAVCA turns 20 in 2018 and we spoke to past and present chairpersons and CEOs to find out how it all began and what the future holds for the private equity industry's advocacy champion.

It is often said that it takes a community of leaders to build a great organisation, and this old aphorism is demonstrated in the creation and evolution of the Southern African Venture Capital and Private Equity Association (SAVCA).

The year was 1998, BlackBerry was among the largest initial public offerings (IPOs) and Long-Term Capital Management's hedge fund was hogging the headlines globally for a bailout that wasn't an ideal advertisement for financial leverage. Armed with an idea and a vision, a group of passionate private equity practitioners including former MD of Business Partners Jo Schwenke, current SAVCA chair, Craig Dreyer, and founding partner at Ethos Andre Roux, and a few others, formed SAVCA. And over the years it has been the ability of the organisation to attract and retain the industry's leaders in key positions that has been the hallmark of its success.

Several years before the formal incorporation of SAVCA,



Jo Schwenke

Schwenke had tried to cobble together the nascent venture capital and private equity industry, with little success.

"It actually all started in the late 1980s. I used to research and keep tabs on all the [venture capital] VC players and I started a club, which eventually never came to anything," Schwenke reveals.

But Schwenke, a great admirer of the European business ethic, wanted to emulate the European Venture Capital and Private Equity Association (EVCA) launched back in 1983 (now called Invest Europe) and so called upon his chairman at Business Partners in 1998 after the early failed attempts to scratch this particular itch. "Johann Rupert," as Schwenke recalls, "was always one to allow you the freedom to pursue projects, so naturally he didn't object."

The "why" centred on wanting to largely self-regulate and wanting regulators to understand the importance of the industry to the South African economy and allow it to reach its ultimate potential. There was also a need to ensure that the "fly-by-nighters", as Schwenke calls them, were isolated through membership and accreditation because there were stories at the time of sharks taking little old ladies' pensions and the like.

"We borrowed the memorandum of incorporation from

EVCA and made small adjustments in a matter of hours and adopted it with six board members in the court at the first meeting," Schwenke recalls. "Craig Dreyer played a huge role in the early days and I never returned for follow-up stints because I went to Luxembourg."

"Going back to 1998 when we started the Association, very few people knew what private equity was about, including myself," says Dreyer, who is the current chairman of SAVCA, "because I was a new player to the industry then. The initial coffee table meetings we had at Jo Schwenke's Business Partners' offices were initially focused on asset class promotion so that when we spoke to the regulators, SARS, National Treasury – and for that matter financial journalists – they had a basic understanding of private equity."



Craig Dreyer

"In the early days there were a handful of us sitting around the table being allocated tasks," recounts Dreyer. "Today, we've got a fully-fledged office and a well-functioning board. In the past six months regulation has become such a big theme that we've also employed a half-day chartered accountant to spearhead that initiative because there's just so much work to do."

Handling the "tsunami" of regulation, and assisting regulators in understanding the impact of various laws on the sector was identified by all past and present chairs and chief executives as one of the core reasons for SAVCA's existence.

After laying the foundations, Schwenke handed over to Malcolm Segal in 2002.

"My objective was to consolidate and to become recognised as the representative of the industry," explains Segal. "Not many people knew or understood the asset class at the time. It was, if I were to use one word, about advocacy. And in order to be acknowledged and regarded as the advocate we needed representation and that meant membership. I would say a big part in the initial phase was to consolidate the membership and get all the major players on board and to recognise the need for an industry and to be contributing not only their time but to pay membership fees." ▶



Malcolm Segal

Industry body warmly received



Growth in private equity 'far from over'

Private equity investment in the UK is set to continue its rapid growth, according to a new survey by the British Venture Capital Association (BVCA). The survey, which is the largest of its kind in the world, found that private equity investment in the UK rose by 15% in 2007, to a total of £10.5 billion. This is a significant increase on the £9.1 billion invested in 2006. The survey also found that private equity investment in the UK is expected to continue to grow in 2008, with a projected increase of 10% to £11.6 billion. The BVCA, which represents the UK's private equity industry, says that the survey shows that private equity investment in the UK is still a very attractive option for investors. It also says that the survey shows that private equity investment in the UK is still a very attractive option for investors.

SAVCA WAS LAUNCHED TO SERVE THE INDUSTRY

SAVCA is a new industry body for the UK's private equity industry. It was launched in 2007 to serve the industry and to promote its interests. SAVCA is a not-for-profit organisation and is funded by its members. It has a number of objectives, including to promote the UK's private equity industry, to provide a platform for the industry to voice its views, and to provide a range of services to its members. SAVCA's first year has been successful, with a number of initiatives being launched, including a new website, a new newsletter, and a new range of events. SAVCA is committed to continuing to serve the industry and to promoting its interests.

SURVEY: SA

Towards venture capital success

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QUITY 2007

Special Projects Division Feature

Strong appetite for medium to small business transactions

The private equity industry is showing a strong appetite for medium to small business transactions, according to a new survey by the British Venture Capital Association (BVCA). The survey, which is the largest of its kind in the world, found that private equity investment in the UK rose by 15% in 2007, to a total of £10.5 billion. This is a significant increase on the £9.1 billion invested in 2006. The survey also found that private equity investment in the UK is expected to continue to grow in 2008, with a projected increase of 10% to £11.6 billion. The BVCA, which represents the UK's private equity industry, says that the survey shows that private equity investment in the UK is still a very attractive option for investors. It also says that the survey shows that private equity investment in the UK is still a very attractive option for investors.

HEALTH WATCH Private equity's image changing

Private equity's image is changing, according to a new survey by the British Venture Capital Association (BVCA). The survey, which is the largest of its kind in the world, found that private equity investment in the UK rose by 15% in 2007, to a total of £10.5 billion. This is a significant increase on the £9.1 billion invested in 2006. The survey also found that private equity investment in the UK is expected to continue to grow in 2008, with a projected increase of 10% to £11.6 billion. The BVCA, which represents the UK's private equity industry, says that the survey shows that private equity investment in the UK is still a very attractive option for investors. It also says that the survey shows that private equity investment in the UK is still a very attractive option for investors.

A short

Global private equity funds raise more than \$20 bn

Global private equity funds have raised more than \$20 billion in the first half of 2008, according to a new survey by the British Venture Capital Association (BVCA). The survey, which is the largest of its kind in the world, found that private equity investment in the UK rose by 15% in 2007, to a total of £10.5 billion. This is a significant increase on the £9.1 billion invested in 2006. The survey also found that private equity investment in the UK is expected to continue to grow in 2008, with a projected increase of 10% to £11.6 billion. The BVCA, which represents the UK's private equity industry, says that the survey shows that private equity investment in the UK is still a very attractive option for investors. It also says that the survey shows that private equity investment in the UK is still a very attractive option for investors.



Powering ahead

Private equity investment in the UK is set to continue its rapid growth, according to a new survey by the British Venture Capital Association (BVCA). The survey, which is the largest of its kind in the world, found that private equity investment in the UK rose by 15% in 2007, to a total of £10.5 billion. This is a significant increase on the £9.1 billion invested in 2006. The survey also found that private equity investment in the UK is expected to continue to grow in 2008, with a projected increase of 10% to £11.6 billion. The BVCA, which represents the UK's private equity industry, says that the survey shows that private equity investment in the UK is still a very attractive option for investors. It also says that the survey shows that private equity investment in the UK is still a very attractive option for investors.





If one extrapolates from there to pay membership fees there had to be a value proposition so the board identified research, training, events, professional standards and responding to regulation as its core business.

"When I took over from Jo [Schwenke] it was really a committee and a part-time secretary, and I suppose at the end of [my tenure] JP [Fourie] was full-time CEO [appointed in 2006]," says Segal.

Before Fourie joined SAVCA he was the JSE's representative on the board.

"[SAVCA] never had a full-time CEO and I joined in [the middle of] 2006, at the advent of the JSE becoming concerned about these public to private transactions happening, Edcon, Consol and the like," explains Fourie. "The industry was being measured by these five or six mega transactions yet at the time was doing, even without Business Partners, probably four or five times that number of transactions with under appreciated positive economic impacts."

Fourie is quite candid about those leveraged buyouts that occurred pre-global financial crisis and the importance of having difficult conversations with Treasury.

"All chips down, some of those LBOs [leveraged buyouts], where debt was provided by non-SA banks or institutions, represented a net loss to the fiscus. That was obviously very concerning to Treasury at the time. So those type of responses were very important, and the overriding one was that you cannot measure this entire industry by five or six LBOs."

And tucked away in those many conversations with Treasury was one of the very early successes in the industry for SAVCA (that many of the new members might be unaware of): the repeal of Section 9b (s9b) and replacement with Section 9c (s9c) of the Income Tax Act going back to 2005. Dreyer was personally involved.

"The previous s9b, recognised only listed instruments as having a safe haven of five years, so if you held a listed instrument for longer than five years it was deemed capital," explains Dreyer. "When it came to private investments there was complete uncertainty in the industry – whether you held it for 10 years or one year – was it capital or revenue? No-one could really tell you. SAVCA then lobbied SARS very seriously at head office in Brooklyn [Pretoria], and we were requested to draft a large research paper on international practice on private instruments.

"We did that study for about nine months and we

presented it to SARS. This resulted in the repeal of s9b and s9c, which was issued on the back of that paper to include private investments as well as listed investments. Plus the period was changed from five years to three years and that was an enormous win for the industry. It also gave investors into the industry a lot of comfort that should they hold those private instruments through partnerships, that they would have tax certainty," says Dreyer.

Fourie also joined an organisation that was not financially self-sustaining and he reveals that SAVCA had to rely on an underwrite (which was never called on) from larger members to fund projects undertaken at the time. He left with the financial cupboards far better stocked and placed SAVCA on a sustainable financial footing.

It wasn't all plain sailing in those heady early days. From financial challenges to managing the characters that come with the territory "it was quite tough in the beginning", reveals Segal.

"Some of it was around egos and competitiveness. Ethos in the form of Craig Dreyer, who has been associated with the industry for a long time and Andre Roux, then CEO, they were really stalwarts and supporters. They were quite key, when the going got tough you could always rely on Ethos. Then we needed to get the Braits and RMBs and the other big players on board and sit in the room as colleagues as opposed to viewing each other as competitors and viewing each other with suspicion."

"For example, we participated in the formulation of the international valuation standard, the IPEV [International Private Equity & Venture Capital Valuation Guidelines], we sat on the international task force, we gave input to the standard and that was a fundamental thing to say that this is the way you value your private equity and your venture capital investments, it gave a credibility to the information that was being put out."

Ethos CEO Stuart MacKenzie believes every industry needs an advocacy body representing member interests and that the private equity industry has been particularly well served by SAVCA over the years: "Without a strong industry body that can work with key stakeholders from regulators through to fund investors, the industry would just be a disparate fragmented collection of people with no common voice. The importance of the common voice is critical particularly for an industry that is still not fully formed from an asset allocation perspective." ▶



JP Fourie



Stuart MacKenzie



Along came the Global Financial Crisis (GFC) and Regulation 28

In 2007, the world had just been introduced to Steve Jobs' iPhone and was about to suffer another crippling blow to confidence as Lehman Brothers collapsed a year later.

At the board level, Mutle Mogase, who was co-founder and executive chairman of the Vantage Capital Group, followed Malcolm Segal as SAVCA chairman in 2006.

"I took over the chairmanship from Malcolm Segal at a very challenging but exciting time. During my tenure we dealt with a number of key transformative initiatives for the private equity industry," says Mogase.

Mogase was a key figure at the time involving himself in BEE debates as well as the codes for the industry. During his tenure Mogase focused on the Financial Sector Charter (FSC) and BEE codes, the definition for private equity, tax treatment of realisation gains, and the inclusion of unlisted debt, mainly mezzanine, in the Regulation 28 definition. "I had and incredibly committed executive and fellow board members that made it possible to complete these significant tasks, and for that I am truly grateful," adds Mogase.

In 2008, as the global financial crisis hit, Cora Fernandez, then deputy CEO of Sanlam Private Equity and already a seasoned SAVCA director, succeeded Mogase, becoming the first female chair of SAVCA, followed by Emile du Toit in 2011.

"The thing that stands out most for me from that time was the tsunami of regulation," recalls Fernandez. "It was post the GFC and financial regulators globally were thinking of how to get participants in the financial services sector to behave in a better way." Fernandez, being a self-confessed optimist, chose to view the experience as an opportunity for the industry to learn.

"We were very fortunate that the regulators had an appetite to listen to us, which, in hindsight, is down to the proactive approach we took."

Du Toit recalls: "It was a difficult time. We had just gone past the credit crisis and following that we had been hit by lots of regulation on various fronts both locally and internationally. Since 2009, even before I was chair, we'd seen a ramp-up in regulation, which required intensive



Mutle Mogase

engagement with the FSB, SARS, a lot of it was internal.

"That was also the time that JP [Fourie] decided to leave the organisation in 2012 [and] we had Malcolm Segal as an interim CEO. We actually lost so much institutional memory and capacity at that time and we brought in Erika van der Merwe, an outsider to the industry but very much a financial commentator and journalist, who really brought a different dynamic."

Van der Merwe reflects: "I would say that my mandate was to raise the profile of the organisation as well as the industry.

"How we did that was to think about what we communicate, how we communicate and to whom we communicate. We were quite deliberate and clear on our key messaging about the industry so all those things – the nature of the industry, the force for good, stewardship – existed but it was about deliberately showcasing that and showing it off whenever we speak about the industry."

Under Van der Merwe's leadership SAVCA also doubled its research efforts.

"There were already well-established research programmes and reports in the annual calendar, but we looked at those and how we could fine tune them and added some research publications, to demonstrate the scale of the industry, the impact of the industry, impact on communities, on businesses, and the broader economy."

Dave Stadler was the chairman during the bulk of Van der Merwe's tenure, and she credits him with playing a significant role in helping her adapt to the cut and thrust of private equity.

"I almost can't put words to it, on a personal level, what it meant to have someone like Dave guiding me, his immense wisdom, experience in the industry in the corporate setting, in the private equity setting, just the way he thinks, he's strategic, he takes in all angles and all possibilities, he's refreshingly open-minded yet passionate about the industry, always wanting to do the right thinking for the industry."

Stadler tells how he sat down with his new CEO in 2014 and reset SAVCA's vision, mission, values, went "back to basics" and set out the strategic goals.

"Largely we recognised that, whereas emerging markets had been the flavour, after 2008, emerging markets were far more segmented and leading the way were emerging markets ▶



Erika van der Merwe



Cora Fernandez



Emile du Toit



Dave Stadler



Asia and Southern Africa were sort of bottom of the pile," explains Stadler. "So that set our focus to create a greater profile for the private equity industry to aid in fund raising, particularly in Southern Africa, and deal flow. To raise the profile for it to be an acceptable asset class for institutional pension funds. That became the prime strategic goal.

"We wanted to give emphasis to research to support our strategic goals; where do we need research? What is the good coming out of private equity? How does it affect the economy? What is the impact? What are pension funds doing in relation to private equity and how acceptable is it as an asset class? And we did all of those [research reports] but clearly the changes to Regulation 28 in 2011 have not been fully taken up by pension funds."

Stadler and Dreyer are in complete agreement that this remains the long-term challenge for the asset class, alongside dealing with regulation.

"We desperately need our own regulation from the FSB as the private equity industry," comments Dreyer. "We've been hobbled in the general FAIS [Financial Advisory and Intermediary Services] legislation, which in my view is very retail orientated. To the FSB's credit, they acknowledge that we need our own regulation, but we need to get there."

Another important aspect is transformation.

Dreyer points out that SAVCA as an industry body is well transformed. However, he believes that the real driver of transformational change sits with SAVCA and its members and in turn how the fund managers influence their portfolio companies.

"SAVCA has an active transformation subcommittee. Recently, however, we expanded its mandate to include promoting transformation amongst SAVCA members. The subcommittee has been tasked with developing a plan and coming back to the SAVCA board in February 2018 to identify initiatives the industry needs to establish."

Back to the future for SAVCA

From global terrorism and the global financial crisis, the world was introduced to an equally disturbing geopolitical trend towards the end of 2016, the rise of the political right and a pushback against globalisation embodied by

controversial US President Donald Trump, Brexit and a wave of pro-right political parties in Europe.

Van der Merwe is certain that new SAVCA CEO, Tanya van Lill, can carry SAVCA forward in this new era.

"Handing over to Tanya provided a fresh set of eyes," explains Van der Merwe. "The foundation was laid with myself and JP, and our previous execs in the industry. And I think at every level it requires creativity, new ways of looking at it really extending the research, going deeper into those relationships with regulators, investors and stakeholders at home and abroad, further institutionalising the organisation, which enables it to generate more resources, a more sustainable infrastructure to serve the industry well."

Dreyer is also optimistic about the future, particularly the progress being made on cracking the 'pension fund nut'.


"I sense a change, especially in the past six months, with many of the pension fund administrators wanting to talk now about private equity where previously it was a bit of a closed shop. There is a recognition that we should be doing something but the how perhaps is not yet done (and getting the commitment is another matter), but I think there are small green shoots. The industry is in a far better space than we were two or three years ago."

Van Lill says with the strong foundations built by Fourie, Van der Merwe and the previous chairs, SAVCA is well positioned to continue being the voice of the industry.

"SAVCA will continue focusing on promoting the asset class, strengthening its advocacy efforts, providing relevant and thought-provoking research and training, and be of value to its members.

"We are in exciting times, and the SAVCA board, executive team and I are honoured to represent this remarkable industry."

As the world gears itself up for a period that is hopefully less volatile than the global financial crisis era, South Africa will undoubtedly benefit from the improving "Goldilocks" macro-economic environment being forecast by the International Monetary Fund (IMF) and World Bank.

Much has been achieved by SAVCA over the past 20 years and, casting one's eye towards the horizon, the future for the industry and SAVCA looks bright. 



Tanya van Lill





Greater than the sum of its parts

by **Andre Roux**
Deputy Chairman: Ethos



Two decades ago, when SAVCA came into being, the world – and the private equity industry – looked vastly different. What changed over this period?

For me, 20 years feels like the blink of an eye! But, the truth is that the world – and private equity in particular – has changed drastically over that period.

As I sit down to pen this article, I find myself smiling and simultaneously shaking my head as I recollect the nascent private equity industry we were trying to build two decades ago. Smiling because the characters were large and ambitions greater. Yet, frowning because we were fragmented and didn't stand for a united cause. More than once, the term Wild West was whispered as an analogy for our industry. And what really resonated with me was a comment by Roger Brooke (our chairman at the time and a pioneer of the British private equity industry). He said: "If you want the industry to progress, you need to speak with one voice."

SAVCA – as a movement and later a fully-fledged entity – was the brainchild of Jo Schwenke (former head of Business Partners). He, myself and a number of other fund managers had been informally meeting to share our experiences, while actively discussing the opportunities we felt the industry offered. Yet, together we also shared a number of rising concerns: questionable ethics by some market players, intensifying reputational risk and a rapidly evolving regulatory environment that we felt ill at ease navigating as individual firms.

The good, the bad and the ugly was our discourse.

Over time, Jo gathered our specific thoughts to collate a shared vision for an industry-led association that held each member to high ethical and business standards.

Subsequently, SAVCA was born in 1998, with ambitions to promote self-regulation and lobby policymakers, as well

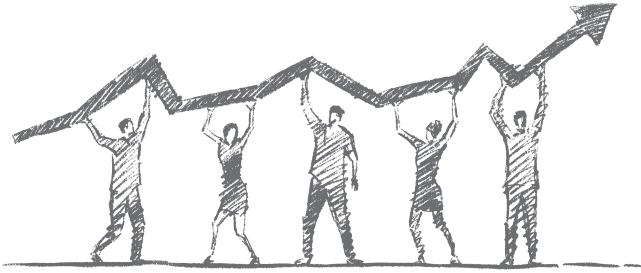
as train and develop industry professionals¹. All while researching and compiling much-needed data on the local market to disseminate to the broader business community. Together, we all firmly believed that a healthy, well-organised, ethical private equity and venture capital industry was good for investors, good for business owners and – most importantly – good for the South African economy.

It is therefore immensely pleasing to me to see the words "promote", "represent", "contribute" and "stimulate" still being used on SAVCA's website today as these were the principles that Ethos upheld (and still safeguards) as a founding member of SAVCA.

In reality, beyond those initial meetings, my personal involvement in SAVCA was relatively limited. Rather, it was Ethos's chief financial officer, Craig Dreyer, who actively participated on the board and numerous sub-committees. In particular, he drove SAVCA to have a voice with the regulators and SARS. In his words: "We didn't want to be retrospectively discovering taxation and financial services legislation at odds with the private equity industry. Rather, we wanted a dialogue with policymakers and to be part of the development of such legislation." However, Craig openly admits that those early meetings were difficult. Only after years of careful negotiation and relationship building is SAVCA now positioned for open debate on regulatory and taxation matters.

Membership grew rapidly in those first few years as other fund managers sought to professionalise and build relationships with other managers, investors, service providers and the banks. It's fascinating to me to flip through the pages of the first SAVCA industry survey, published in ►

¹ Jo's relationship with the European Private Equity and Venture Capital Association, meant that we were able to use their Charter – adapted for local conditions – as a basis for SAVCA. This meant we had a solid foundation and were able to move quickly to establish our Association.




2000, which describes an industry with R27.5 billion in assets under management. In SAVCA's most recent survey, assets under management totalled R171.8 billion in 2016! I'm not sure that Jo, myself or any of the founding firms foresaw an increase of that magnitude 20 years ago.

I believe (and I'm sure the other founding firms will concur) that ours is a story of shared success; thanks in no small way to SAVCA. Only by pulling together as an

industry did the efforts of individual firms translate into a vibrant, professional, attractive industry. SAVCA really is greater than the sum of the parts.

As I conclude my reflections, I recognise that mine was a generation of calculated risk-takers, thoughtful pioneers and a handful of mavericks. Yet, over three decades, we crafted an industry that has become an employer of choice, a valued contributor to the asset management community, and a catalyst of best practice and growth in the wider South African economy.

As founding partners – like myself – step away from executive roles as part of natural succession, I am encouraged by the new generation of leaders emerging across local fund managers. And I urge them to continue to work in collaboration, build authentic, open relationships, and hold one another accountable to be positive influencers within our investments, business communities and society at large. As in all aspects of life, never forget that principles and values – notwithstanding their initial costs – will always be bargains in the end. 



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Two decades of regulatory advocacy

by **Richard Flett**

Managing Director: Horizon Equity Partners

20

Over the past 20 years, SAVCA has played an integral part in shaping the legislation that governs the industry, reducing regulatory headaches for general partners.


The regulatory environment was a simpler, kinder place for South Africa's private equity firms at the end of the last century. All this started changing dramatically in the early 2000s through the introduction of new legislation such as the Competition Act, the Financial Advisory and Intermediary Services (FAIS) Act, the Financial Intelligence Centre (FIC) Act, broad-based black economic empowerment (BBBEE) Codes as well as extensive amendments to the Tax Act (including the introduction of capital gains tax – CGT), the Companies Act, the Pension Funds Act and Exchange Control regulations. Not to mention foreign legislation such as the Foreign Account Tax Compliance Act (FATCA), Common Reporting Standard (CRS) and the Alternative Investment Fund Managers Directive (AIFMD). In recent years the industry has experienced a veritable regulatory tsunami, to the point where today all general partners (GPs) accept the need for a weighty and costly compliance function as part of their business model.

Very little of this new legislation was designed around private equity (PE) or venture capital (VC) investment, leading to problematic interpretation and implementation by GPs doing their best to comply. Approaches by individual GPs to regulators to resolve issues were generally not welcome, and instead SAVCA has progressively responded to the most egregious examples of regulatory misfit through targeted lobbying of numerous regulators and government ministries. From a GP's perspective, there have been some significant wins, such as:

- Various exemptions from the FAIS Code of Conduct without which no GP would be able to legally operate the industry's standard model of fund management. A big win here was the exemption for deal executives and key individuals from sitting the dreaded RE1 and RE5 exams respectively.
- The inclusion of PE funds as a distinct category within

the amended Regulation 28 of the Pension Funds Act together with a significantly hiked prudential limit, enabling greater commitments by local pension funds to private equity.

- The introduction of the S12J tax regime, a tax favoured investment vehicle to catalyse greater investment in start-ups as well as small and micro enterprises. After a poor start, subsequent lobbying by SAVCA produced a useful set of amendments that has seen the number of S12J Venture Capital Companies take off recently.
- A reduction in the proposed limits on interest deductibility in S23N of the Income Tax Act, necessary to maintain the viability of even modestly leveraged transactions.
- The introduction of an e-filing based system for nil returns under FATCA and CRS, offering a lower cost reporting alternative to a costly dedicated IT development by each GP.
- Relaxations in exchange control facilitating both fund formation and external investment; more recently we have also seen the Reserve Bank responding directly to industry lobbying through relaxations on the export of IP and on loop structures (although the present wording of the revised regulations is unfortunately flawed).

Most GPs will appreciate these results. Greater regulation has become a permanent feature of the private equity industry's operating environment worldwide and it seems all GPs must adapt to survive. While the flow of new and amended legislation seems unstoppable, SAVCA has a vital role to play in heading off some of the worst impacts on our industry through greater involvement in the drafting and consultation stage. Raising awareness among policymakers, legislators and regulators of how the industry operates will be critical. 



Fund raising: LP perspective

by **Jeremy Cleaver**

Portfolio Director, Intermediated Equity (Africa): CDC Group

How has the fund raising landscape changed over the past few years from an LP perspective?

JC: The fund raising environment for African private equity has become substantially more difficult in the past few years. This has been driven by a number of things, including changes in the macro environment and investor perceptions from positive, to mixed, to a position where there are now only a few bright spots. Macro uncertainty has fed into reduced investee performance and a more challenging exit environment. International investors that tested the waters between about 2010 and 2015 are seeing much stronger performance, relatively speaking, from other markets and have therefore pulled back from Africa, many preferring to invest through funds of funds. At the same time, development finance institution (DFI) mandates remain mixed, with some like CDC focused on funds or intermediated investments across the board and others preferring to use their funds programme to gain access to co-investments. These factors have meant that fund raising timelines have been pushed out and it has become more difficult to achieve sustainable fund sizes.

A few areas have seen increased focus in recent years. Venture capital (VC) funds are seeing increased interest, particularly from DFIs. CDC backs VC investors because they support the businesses of the future and can broaden a country's economic base. In addition, impact funds are also a core focus for many DFIs, family offices, foundations and commercial investors. There remains a very significant need for investment in areas that may be slightly sub-commercial but where improvements in livelihoods, access to markets, access to finance, etc are critical.

Considering the general partners (GPs) that have recently been successful in fund raising, what can their colleagues or peers learn from their approach?

JC: Given the issues outlined above, fund managers should focus on their competitive advantages more than ever. What is the team really good at? Does their track record bear this out? How does the fund's strategy link to these things? How is this strategy differentiated from those of other funds that might already have raised or be in the market?

When it comes to considering fund managers with a track record, obviously historical performance is key. However as more and more fund managers in Africa move towards maturity, we hope to see them investing more in their

people and becoming more institutional. This may mean refreshing teams by promoting or bringing in dynamic talent, increasing their ability to manage key functions internally (i.e. environment and social (E&S), business integrity, legal, etc), bringing in operational expertise to support value-creation, reassessing the way incentives are spread across teams to ensure long term alignment etc. Strong historical performance is not necessarily a good indicator of future performance and the ability to leverage such success for long-term benefit to the manager and its investors is very important.


DFIs and some funds of funds will often be open to investing with first-time fund managers in order to support the development of the overall private equity market. Telling a credible and differentiated story is critical. In many cases, there are multiple fund proposals that are the same or very similar and we will assess them based on our needs.

Finally, for CDC and many others, a core focus on E&S and business integrity is critical. For us these are not nice to have. They are essential pieces of the puzzle and bring value in and of themselves, particularly when it comes to selling portfolio companies.

How can GPs best position themselves to LPs when fund raising in the future?

JC: It's important to be true to who you are as a team and not try to be everything to everyone. Clearly you'll need to be a bit flexible but you will never please everyone and it is much more attractive to us as an investor if, as noted in the previous question, you show a clear, differentiated strategy that links well to the team's skills and track record. For those that are raising follow on funds, key leading indicators of poor performance in CDC's portfolio include large step changes in strategy (i.e. fund size, geographic coverage, sector coverage, etc).

If you want to try something a bit different, and you have a compelling reason to do so, test the market, starting with the LPs who you have the closest relationships with. Various investors are open to new ideas and structures, but it also may limit your investor universe. It's not a good idea to try something new simply because it is the idea of the moment.

Again, as noted above, for CDC and many other LPs in Africa, a serious and clear focus on environmental, social and business integrity issues is non-negotiable. 

Industry activity in Southern Africa 2016–2017 (to date)

Source: Africa Global Funds

Capital Group co-invests in Tsebo
// January 15, 2017

Carlyle to acquire Global Credit Rating
// January 17, 2017

GAIA acquires 25.2% stake in Dorper
Wind Farm // January 26, 2017

Ethos Mid Market Fund I completes
three acquisitions // February 3, 2017

Carlyle acquires CMC Networks
// February 7, 2017

Capitalworks to acquire Aon's
shareholding in 10 SSA countries
// February 21, 2017

Trustco secures up to \$40m from Helios
// February 27, 2017

Medu Capital takes 15% stake in HeroTel
// February 28, 2017

FWA completes takeover of Imara
// March 2, 2017

TA Associates makes maiden investment
in Africa // March 8, 2017

DEG invests R100m in Southern African
fashion retailer // March 11, 2017

Kleoss takes stake in Debt Rescue
// March 16, 2017

Mara Delta invests in Beachcomber
Hospitality Investments
// March 20, 2017

SAAD Investment Holdings and others
invest in Pargo // March 23, 2017

8 Miles backs tropical fruit producer
// March 27, 2017

KNF Ventures backs Quicket
// March 31, 2017

ARC invests in new South African
stock exchange // April 4, 2017

Ethos Fund VI acquires stake in
Little Green Beverages
// April 30, 2017

Vumela makes investments in education
and technology in South Africa
// May 8, 2017

Mergence acquires stake in SA trade
commodity finance firm // May 9, 2017

Quona Capital invests in AllLife
// May 17, 2017

Vostok New Ventures backs South African
online car buying service // May 17, 2017

Caleo Capital & Secha Capital form 12J
investment vehicle // May 22, 2017

ASOC Fund I concludes first deal
// June 6, 2017

RMI and NPI in SA fintech deal
// June 7, 2017

EAIF backs \$76m 40MW solar farm in
Mozambique // June 8, 2017

EAIF invests in Madagascar airports
// June 30, 2017

Phatisa increases shareholding in
Kanu Equipment // July 6, 2017

Long4Life acquires Sorbet
// July 21, 2017

Greycroft Partners and others in
Flutterwave deal // August 3, 2017

Vakayi Capital makes first investment
in Zimbabwe // August 4, 2017

PAIDF2 invests in rail company
// August 9, 2017

Enko Africa Private Equity Fund invests
in AMI Logistics // August 14, 2017

Kalon invest R7m in SnapnSave
// August 15, 2017

EMR Capital to acquire Zambian mine
// August 21, 2017

Arise becomes second largest shareholder
in NMBZ // August 22, 2017

SIH to acquire EasyEquities
// August 23, 2017

Long4Life acquires Inhle Beverages
// August 24, 2017

Secha Capital backs SA biltong brand
// August 24, 2017

1K1V in aquaculture deal
// August 29, 2017

AgDevCo and Nika invest in Citrum
// September 5, 2017

ARC buys 20% of Rain South Africa
// September 6, 2017

New investors back Ethos' expansion
strategy // September 19, 2017

Private equity consortium backs Kevro
// October 9, 2017

NMCF acquires Swanib Cables
// October 11, 2017

CRE Venture Capital-led consortium
invest in Andela // October 17, 2017

OMRAF acquires 50% stake in Faircape
// October 18, 2017

Investec and RMB in largest Botswana PE
investment // October 23, 2017

Carlyle to support NOSA's global
growth // October 25, 2017

HAVAÍC, Growth Grid back Digital
Cabinet // October 31, 2017

Musa Group invests in Lehae affordable
housing project // November 1, 2017

Yellowwoods and Hollard in South African
insure tech business deal
// November 7, 2017

Convergence acquires stake in ESET
Southern Africa // November 9, 2017

10X Investments gets \$6.14m in new
funding // November 14, 2017

Kibo Capital Partners acquires stake in
Tropigalia // November 15, 2017

Kalon Venture Partners invests in i-Pay
// November 20, 2017

HAVAÍC-led consortium invests in RMed
Online // December 1, 2017



INSIGHT



Private equity trends: Deals, exits and fund raising trends

Over the past two decades, the private equity space in Southern Africa has changed dramatically. The sector continues to adapt to the unique needs of investors in the region and has learned to roll with often unpredictable currency fluctuations and political developments.

A lot can happen over the course of 20 years. The private equity (PE) market in the South African region has gone through some rather drastic changes, and with the pace at which our modern world is advancing, there's no telling what the next few years will bring.

Lydia Shadrach-Razzino, director at ENSafrica, says that 20 years ago the majority of PE investors were more passive investors, while in the past 10 to 15 years there has been a shift to active investing. "Dealmakers have become more involved in the business of target companies thereby more efficiently creating and unlocking value."



Lydia Shadrach-Razzino

The nature of PE deal-making in Southern Africa has ebbed and flowed with political instability and currency risks in the region. However, Southern African PE dealmakers have been resilient, says Shadrach-Razzino, and that has been the greatest strength of the industry.

"One of the most significant changes I have seen has been the use of warranty and indemnity insurance in the deal-making process – it reduces risk and time to close a deal. There has also been a greater focus on driving good corporate governance and anti-bribery and corruption policies in recent times," she adds.



Graham Stokoe

Graham Stokoe, EY's private equity leader in South Africa and Africa, says the mid-cap deal space has been at the heart of South African PE: "The difficulty in doing delistings, being public to private [PIPE] deals has also probably led to the large cap deal space not expanding that much."

Nevertheless, Wildu du Plessis, head of Africa at Baker McKenzie in Johannesburg, adds that there are some sizeable 'sponsor-held' assets that we will see 'in play' in the relatively near term. "The extent to which certain of these may now be of a scale to be attractive to the international capital markets, and thus begin to dilute the predominance of the trade sale as an exit route on the continent, also presents an interesting dynamic," he says.

Wildu du Plessis



For John Bellew, head of private equity sector group at Bowmans, the key difference between deals today and 20 years ago is that the legal environment has become much more complex: "Twenty years ago merger control was a non-issue, there was no capital gains tax and tax deductibility was far simpler. The taxation of share incentive schemes was unsophisticated and so it was generally much simpler to structure deals."

John Bellew



The number of private equity houses grew exponentially as the market matured and segmented. In the last few years there has been a lot of interrogation of the traditional private equity 2 and 20 model, according to Bellew. "There is a view that the lifespan of a traditional PE fund is too short for African investments, and there is a push towards longer-dated or permanent capital vehicles," he says.

The length of time and associated cost and uncertainty of the traditional fund raising model has also prompted PE houses to look to the public markets to raise capital. "Funds are also looking at alternative options such as pledge ►



funds to assist in raising funds in a difficult macro-economic environment," he adds.

As a result of the instability in the region, there have been a number of exits over the last two years and most occurring in South Africa. The number auction process exits has increased as well as private equity-to-private equity disposals.

Shadrach-Razzino says there have also been some massive losses on exits only to find that the next investor manages a great turnaround and a quick exit at a profit. "What is clear though is that PE investors are attracted to assets owned by other PE investors."


Bellew adds that in the South African market exits by way of IPO have always taken place, and the right exit route will often depend on market conditions. "Exit listings therefore tend to come and go in cycles. There was no real auction market as we know it today, but the traditional buyers remain trade players and other financial buyers."

The future of the industry looks bright and is evolving to meet the unique demands of Africa and in response to different investor needs. "The story of PE in Africa has

been of growing stronger and better companies, generating jobs and, in the South African context, creating opportunities for BEE ownership of companies," comments Bellew.

There are many undervalued sectors in Southern Africa, which could use a private equity investment boost, thinks Shadrach-Razzino, adding that dealmakers will have to get a bit more creative if the true value and potential is to be unlocked. "Dealmakers will have to be ready to roll up their sleeves and get their hands dirty with hands on management in order to build from inside out and create value," she says.

The main driver of private equity returns in Africa is the ability of private equity portfolio companies to exponentially grow revenues and greatly scale up businesses. Stokoe says: "PE investors and PE industry are thus a key catalyst to supporting entrepreneurs and other stakeholders grow their leading businesses."

Du Plessis adds: "Returns for PE transactions can be far higher than in developed markets and at the same time, private equity investors will continue to play a catalytic role for investment in Africa." 

Deal Tracker | Agriculture and Food

PE Fund
Target company
Industry
Deal value
% shareholding taken
Date

Capitalworks Private Equity Fund II
Sovereign Foods Limited
Food
R907 million
Majority
November 2017

Comment

Capitalworks delisted Sovereign Foods, which is one of the leading poultry producers in South Africa.

PE Fund
Target company
Industry
Deal value
% shareholding taken
Date

sefa Awethu Youth Fund (sAYF)
Maneli Foods
Agro-Processing
R74 million
7% with performance ratchets
June 2016

Comment

One of South Africa's first "Search Fund" investments, Maneli Foods is a black-owned, diversified food company that owns and operates various food businesses. The company currently has two subsidiaries: Maneli Commodities, a grain trading company based in Paarl, and Maneli Pets, a manufacturer/exporter of premium pet treats. Maneli Foods has grown to R70m in revenue and 90 employees with a view to ultimately becoming the largest black-owned food business in the world.

Fund raising and fund launches by private equity in Southern Africa and beyond

2017 (to date)

Source: Africa Global Funds

Rocket Internet's Fund reaches final closing // January 23, 2017

Inspired Evolution targets \$250m for its second fund // January 25, 2017

Agri-Vie Fund II touches first close // February 1, 2017

Apis Growth Fund I closes above target // March 6, 2017

Mediterranea Capital aims to raise €250m for new fund // March 7, 2017

Actis Energy 4 closes at \$2.75bn // March 8, 2017

Accion Frontier Inclusion Fund oversubscribed, closes at \$141m // March 14, 2017

Phatisa's new food fund aims to raise \$300m // March 20, 2017

Catalyst Fund II hits first close at over \$100m // March 27, 2017

MAREF closes at \$170m // April 5, 2017

African Rivers Fund reaches final close at \$50m // May 15, 2017

Frontier Energy II announces first close with \$116m commitments // May 16, 2017

Victus Global Capital to bring Gender Lens Investing to Africa // May 29, 2017

Adenia Capital (IV) closed above target // May 31, 2017

Fanisi targets Sh10bn for its second fund // June 14, 2017

AfDB, CDC, DGGF invest \$31m in FAFIN // June 22, 2017

TLcom raises \$40m for TIDE Africa // June 28, 2017

Yeelen Financial Fund raises €30m // July 12, 2017

NBKCP Mezzanine Fund II closed with \$160m in capital commitments // September 19, 2017

AAF gets \$25m for inaugural venture fund // October 2, 2017

PFF2 gets \$10m from AfDB and targets Q1 2018 first close // November 27, 2017

MC III hits first close at €103m / // November 27, 2017

Maghreb Private Equity Fund IV hits first close // December 4, 2017



The privacy of private equity deal flow activity

by **Dave Stadler**
CEO: Paean Private Equity



While there continues to be limited public information available on concluded private equity deals, it is possible to deduce some metrics of private equity deal-making activity.

In the earlier years of practising private equity in Southern Africa, private equity was indeed considered 'private' with little flow of real deal information. Deal information was private and confidential! The private equity industry was considered to be non-transparent by outsiders.

Since those earlier years, the private equity industry has become far more public, with a greater camaraderie among private equity practitioners. Through SAVCA, there has been a focus on, amongst other matters, industry performance and returns. However, there remains little public information of concluded deals, not only in terms of deals actually concluded but also in respect of deal values, multiples paid, shareholding and exit information. Confidentiality is understandable and is to be adhered to, but it would nevertheless be useful empirical information in extolling the positive virtues of private equity and the contribution that it makes to the economies in Southern Africa. To date, there has been some outstanding research produced by SAVCA and more detailed information on deals concluded would support its catalogue of research material.

Thus, from reported deal information that has been collated*, there were some 153 significant African deals recorded in the calendar year 2017. This is a substantial decrease from the deals recorded across Africa in the year 2016. It was a tough year in 2017! It is acknowledged that the smaller deals are less likely to be reported than larger, high-profile deals.

Of those deals disclosed, approximately 41% were carried out in Southern Africa (defined for this purpose as SADC). 31% were completed in South Africa. By comparison, in the year 2016, about half of deals in Africa were concluded in Southern Africa, of which some 65% of those were in South Africa.


Of the deal values disclosed in South Africa, 56% were reported to have had deal values of less than R100 million,

22% with deal values between R100 million and R500 million and 22% with deal values between R500 million and R1 billion. This compares to approximately one third of deals concluded in Africa with deal values below R100 million, some 29% of deals concluded being between R100 million and R500 million and some 40% of deals between R500 million and R1 billion in the year 2016. There were no reported private equity investment deal values recorded in South Africa greater than R1 billion in 2017! This contrasts with 2016, when there were a number of deals greater than R1 billion, including Tsebo, Safripol, Kwikot and Eazi Group. Significantly, there were some 28% of deals across Africa with recorded deal values in excess of R1 billion in 2017.

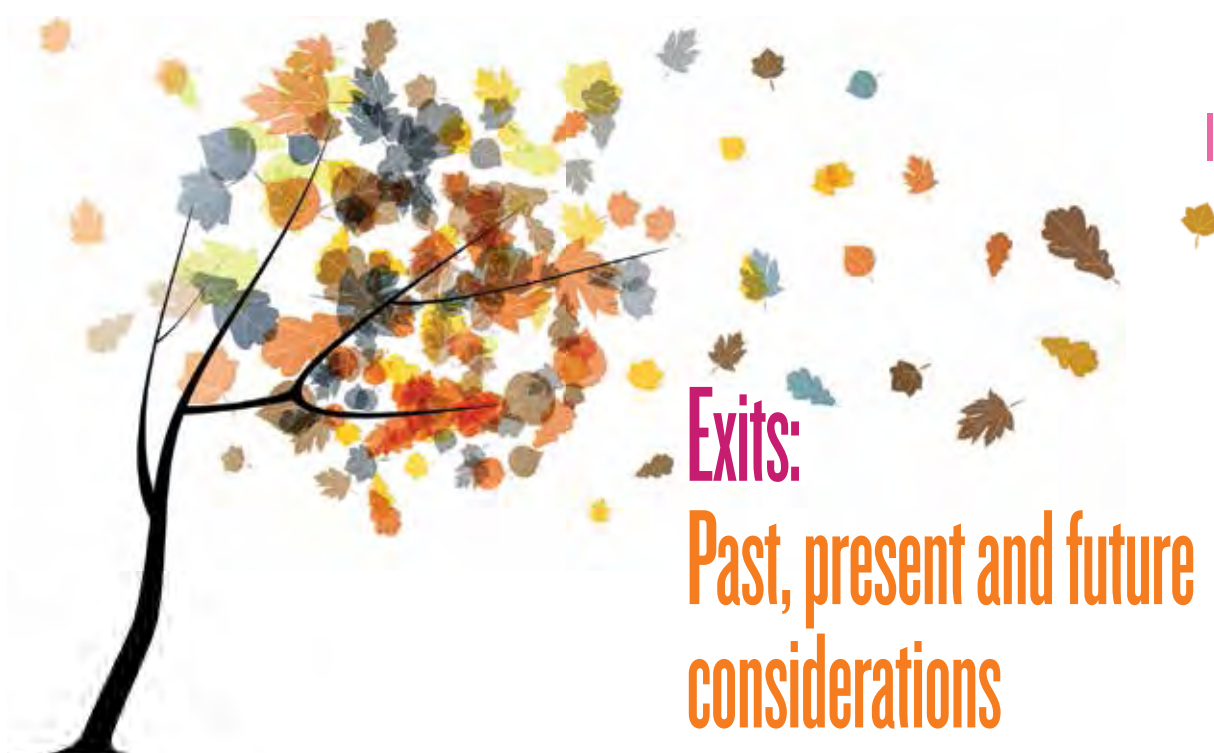
While the shareholding of reported deals in South Africa was not disclosed in more than half of the deals recorded, approximately 39% of those deals disclosed minority stakes, some 28% were significant minority stakes (greater than 25% but less than 50%) while about 33% were majority investments.

The most popular industry sectors in South Africa that private equity invested into in 2017 were telecommunications and technology, retail, and financial services. These industry sectors align with the sectors invested into across Africa, other than financial services being more favoured than retail across Africa.

The number of private equity exits recorded across Africa in 2017 was 25% lower than in 2016 while exits in Southern Africa were reported to be in line with 2016.

While this brief review of deal flow information available is somewhat limited by a lack of full deal flow information, it nevertheless provides an analysis of the public information of private equity deals concluded, deal value distribution, shareholdings by private equity firms and the focus by those firms on industry sectors. Some deal disclosure at least provides potential investors with a limited degree of private equity industry metrics and transparency! 

* The research data used in this article was supplied by Webber Wentzel using information that is available in the public domain.



Exits: Past, present and future considerations

While 2017 only saw a trickle of divestments, some private equity firms nevertheless managed impressive sell-offs during the period.

In 2017, private equity fund managers in the Southern African region were barely active on the divestment front. The political environment and weak economic macros have increased uncertainty, therefore impacting pricing.

There was some secondary activity, though less than in recent years as some of the big-check funds have pulled back, says Peter Baird, managing principal – head of African private equity at Investec Asset Management. “A few strategic investors came back in (e.g. Marubeni buying Standard Chartered out of ETG), but activity was relatively muted.”

“[There were] no IPOs to speak of. My guess is that this was the lowest dollar volumes of exits across the African PE industry in the last few years. Anything that got done required real persistence and probably some creativity,” he adds.

In 2017, Investec Private Equity completed its first three exits, all from Fund 1. In the South African region, the firm exited from its mezzanine investment in SA Taxi, the first financial services provider to focus solely on the taxi industry in South Africa.

According to Andrew Dewar, managing partner at Rockwood Private Equity, there haven’t been a lot of substantial exits for some time, but recently SA fund managers are starting to realise their assets. “While the macro environment hasn’t been conducive to exits, certain assets have attracted attention,” he says.

Last year Rockwood Private Equity successfully completed the sale of Tsebo and Safripol, two of the largest private equity exits in South African history, with an enterprise value of R5.35 billion and R4.1 billion respectively. “As part of

private equity fund managers we always planned to exit the businesses. We initiated the sale of the assets in 2016 and the processes took nine months to complete. We are preparing for the sale of the remaining assets and expect to generate considerable interest,” comments Dewar.

“We are very happy with the rand and dollar-based returns we were able to provide our investors. We grew Tsebo into a pan-African business, which attracted a lot of interest from international buyers and was sold to a listed French investment company. Safripol was a niched asset which didn’t have a long list of prospective buyers and was sold to a SA trade buyer. Specific expertise was required to find the right buyer,” he adds.

In South Africa, the most notable exit for RMB Corvest was its sale of Kwikot to AB Electrolux in March 2017. Mike Donaldson, director of RMB Corvest, says that as a medium-term investor Corvest benefits from not having exit timing pressures.

“Consequently, we have the flexibility to meet the exit timing preferences of our investment partners or alternatively, we can time our disposals to benefit from attractive economic tail winds, enabling us to exit into growth.” He adds that October 2017 saw an unprecedented string of disposals with Corvest exiting MineRP, Crisp Air, Chicken Management Services and Micros.

“We continued the momentum into November with the sale of Autotrader, the well-known and leading online automotive marketplace, in a deal that saw the shareholding consortium including Management and Corvest offloading the company to JSE-listed Naspers,” says Donaldson.

“We were invested in Autotrader for four years, which is short by our standards, but this is a good example of ▶



Peter Baird



Andrew Dewar



Mike Donaldson



Corvest's flexibility where the timing suited all our partners and the opportunity presented by Naspers was a great fit for the business and the management team," he adds.

While trade sales dominated the divestment scene, Tarryn Butcher, manager – transaction support at Actis, says that public equity and capital markets are developing across Africa and are starting to attract more foreign capital. As a result, IPOs will become a bigger feature of



Tarryn Butcher

exits, she adds: "We've already exited via IPO across a number of markets, such as Egypt, Uganda, Kenya and South Africa. To be successful, you need to be certain that there will be sufficient interest, including from foreign investors as this gives you better pricing power, and you need to be listing a relatively large business, of which there are few in Africa."

The market for exits is still relatively difficult, says Baird, but there are always buyers for quality assets at reasonable prices. "The best preparation for a good exit is to work with managers and fellow shareholders to build a great company," he says.

Dewar agrees: "Successful exits require thorough planning, good timing and a little bit of good luck."

Wildu du Plessis, head of Africa at Baker McKenzie in Johannesburg, says while many of the A-list Africa funds are delivering returns, they are going to have to focus in the next 12-24 months on showing their limited partners that they can properly get out of these deals. "A lot of funds rely on the recycling of internally generated operating capital to return money to investors. Exits will become more important as the bigger funds go back into the market. They'll need to demonstrate some strategies on the exit side," he concludes. 



Wildu du Plessis

A sample of industry exits in Southern Africa 2017 (to date)

Source: Africa Global Funds

Evolution One Fund exits four renewable energy assets
// January 24, 2017

FlightScope announces management buyback
// February 13, 2017

Investec exits SA Taxi
// April 28, 2017

Metier exits Inhep and Astrapak
// June 19, 2017

Agri-Vie exits Fairfield Dairy
// July 3, 2017

Spirit Capital exits Tidy Files
// September 7, 2017

Metier and AMDA exit AE AMD
// November 29, 2017

Deal Tracker | Business Services

PE Fund
Target company
Industry
Deal value
% shareholding taken
Date

Capitalworks Private Equity Fund II
IQ Business (Pty) Ltd
Management consulting
Not disclosed
Significant minority
December 2016

Comment

Capitalworks invested alongside management, existing shareholders and Tiso Investment Holdings in acquiring IQ Business, the leading independent management consulting firm in South Africa. Established in 1998, IQ has built a team of over 550 IQers in Johannesburg and Cape Town.

PE Fund
Target company

Capitalworks Private Equity Fund II
Ten of the African operations of Aon plc, now held through Minet Holdings Africa (Pty) Ltd

Industry

Insurance broking and employee benefit consulting

Deal value
% shareholding taken

Not disclosed
100% held by Capitalworks and management

Date

November 2017

Comment

Capitalworks acquired most of Aon's African insurance broking operations and has entered into a long-term, exclusive correspondent agreement with Aon on the continent.



The evolution of the private equity secondaries market in South Africa: Access for buyers, liquidity for sellers

by **Juan Coetzer**

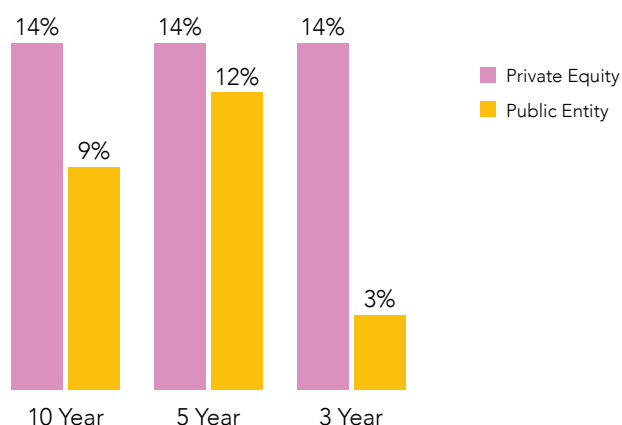
Head of Private Equity: Ashburton Investments

South African investors are faced with a number of challenges, and while many investors have made the decision to invest as much as they can offshore most of us resident here (in particular pension and provident funds) do not have a choice other than to invest a portion of our portfolios in South Africa and then of course the next question is where can one still get a decent return within acceptable levels of risk. Private equity investors in South Africa have been on the receiving end of attractive returns over the long term. According to SAVCA, the pooled returns for private

equity in South Africa have outperformed public markets consistently over the long term (Figure 1 below). However, Naspers makes up such a substantial portion of the JSE All Share Index (ALSI), particularly due to its shareholding in Tencent, so to see a more realistic comparison it makes sense to exclude Naspers (Figure 2). The difference between public returns and private equity returns over the last 10-year, 5-year and 3-year periods would then be 7%, 9% and 1% respectively for public returns, compared to 14% for private equity returns over the same periods. ▶

Figure 1: SA Private Equity pooled IRR vs. ALSI

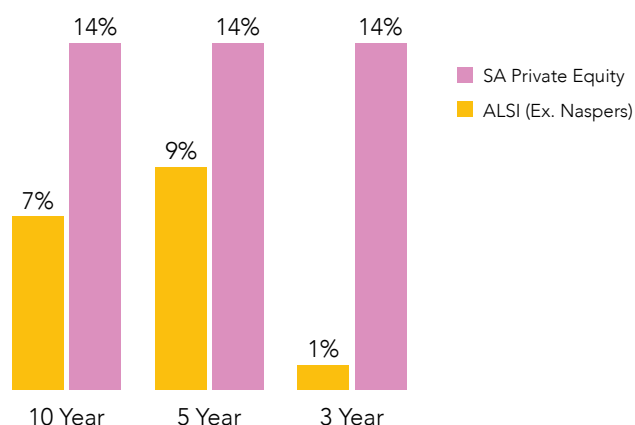
Private equity outperformed listed equity over 10 years



Source: RisCura - SAVCA South African Private Equity Performance Report (2Q 2017)

Figure 2: SA Private Equity pooled IRR vs. ALSI (Ex. Naspers)

Private equity outperformed listed equity significantly over 3, 5 and 10 years



Source: RisCura - SAVCA South African Private Equity Performance Report (2Q 2017), Bloomberg, and Ashburton Investments proprietary research

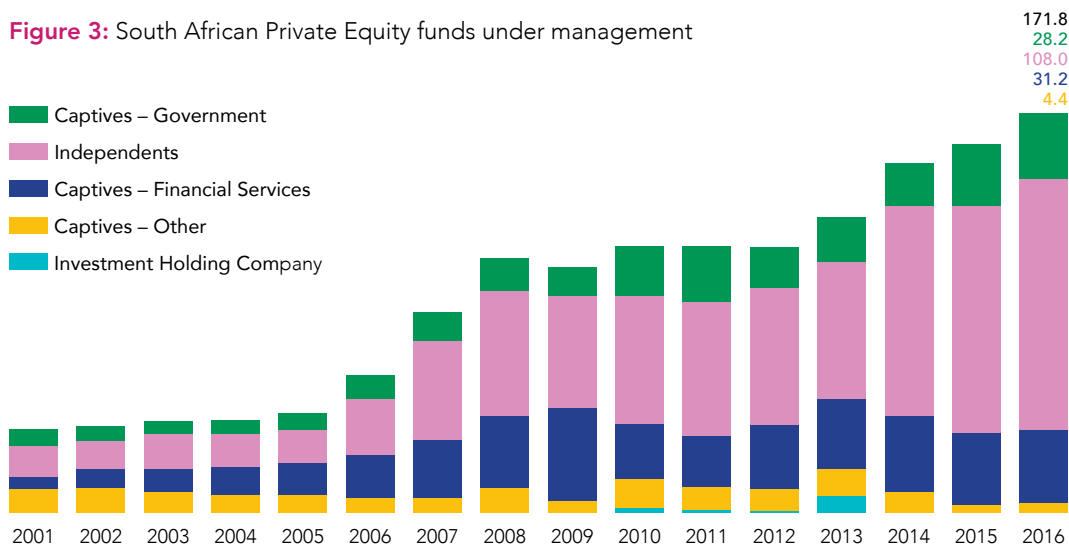
Although South African private equity continues to deliver superior returns, we live in a time where the unexpected seems to have become the norm rather than the exception, leading to investors searching for greater yield with less volatility combined with optionality and ability to trade when they need to.

Up until recently the private equity secondary fund market in South Africa has been limited and opportunistic. A secondary private equity transaction involves the sale and purchase of an investor's existing interest in a private equity fund, e.g. the remaining assets as well as the remaining fund commitment to meet future capital calls for new investments, fees or follow-on investments. In any market, the growth of secondary activities is driven by (i) volume of the primary market, (ii) investment structures, and (iii) participants willing to buy and sell. The private equity (primary) market in South Africa has grown by 190% (see Figure 3) over the last decade, is well established and well developed. Since 1999 the industry has achieved a compound annual growth rate of 11.4% of funds under management, dominated by late stage private equity funds (i.e. relatively very few venture capital and/or early stage private equity funds under management).

investor wants to sell its interest in a fund, the other partners/ investors would have the first right of refusal to that stake before it could be sold to a third party. In addition, it also requires approval from the 'General Partner', or simply put the private equity management team, before it can be sold to a third party. Although there are often similarities, private equity funds may have the different terms ('hurdle rates', 'catch-up', carried interest on a 'whole-fund' basis versus carried interest on a 'deal-by-deal' basis, to name a few), which can influence the pricing of a secondary significantly. This combined with the fact that private equity fund commitments are by their nature long-term and illiquid, do not exactly make them 'trading'-friendly investments, hence the existence of specialised participants are needed to spur the evolution of a secondaries market for these assets.

An active secondary fund market is important for the growth of the private equity industry as it provides liquidity for an illiquid asset class. It is the only way for investors to exit early before the expiry of a private equity fund's 10 to 12-year term. Besides for an early return before maturity, it also makes it possible for investors (i.e. sellers) to actively manage their portfolios in response to macro-economic, regulatory or strategic changes.

Figure 3: South African Private Equity funds under management



Source: SAVCA 2017 Private Equity Industry Survey

Overseas, particularly in the US and Europe, private equity secondary markets are very active. Although the volume of the primary private equity market in South Africa has reached the point where it justifies a more active secondaries market, the question is why has this not yet happened locally. The answer lies within the second and third drivers, i.e. the way private equity funds are structured and the lack of active buyers in the secondary market. Most private equity funds are structured as limited liability partnerships (or en commandite partnerships), mainly for its beneficial look-through tax advantages (which is important because the largest investors in private equity are non-tax paying, e.g. pension and provident funds) and its limited liability status for investors. These partnerships are often subject to a 'right of first refusal' or 'pre-emptive' processes, meaning that when a partner/

The attractiveness of secondaries for investors (buyers)

Secondary private equity fund investments are attractive to investors for the following reasons:

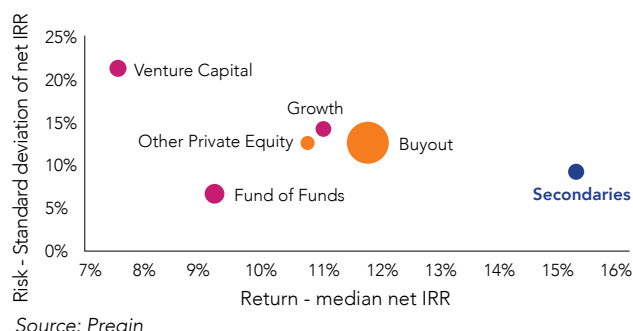
1. Diversification

One of the greatest benefits of allocating capital to a secondaries fund is to gain diversified exposure to known private equity positions. Like traditional fund-of-funds, secondary funds also provide investors with diversification by assets, fund manager, geography, industry sector, investment strategy, etc. However, secondary funds have the added advantage of vintage year diversification and the benefit of hindsight. The ability to invest into carefully selected and matured portfolio with a single commitment is particularly attractive. ▶

2. Attractive risk-adjusted returns

The private equity secondaries market are by its nature an inefficient market, which often creates opportunities for superior risk-adjusted returns.

Figure 4: Risk-return profile of private equity strategies (worldwide)

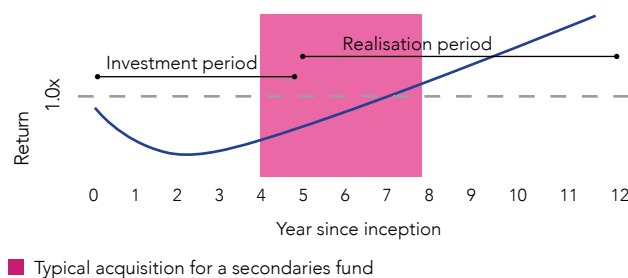


Depending on the quality of the underlying assets left in the fund, secondary fund commitments could sometimes be bought at a discount, especially when limited or no other buyers are present in the market. The so-called 'blind-pool' risk that is associated with primary fund commitments or traditional fund-of-funds are also eliminated, because in secondary transactions the assets of the fund are known and often fully-funded, hence the ability to perform a bottom-up valuation to determine the exact price to be paid. It is therefore possible to generate attractive returns with significantly lower risk. As can be seen from Figure 4 above, secondaries are clearly very attractive from a risk-return perspective.

3. Smooth 'J-curve effect'

Secondaries can deliver a more evenly distributed risk-adjusted return over time. In the first few years of a private equity fund, an investor will typically experience a certain period of negative returns due to the outflow of capital for investments and management fees (the 'J-curve effect'). A secondary investment would typically mitigate this effect, because the buyer of a secondary would acquire the original fund commitment at a later stage and does not refund previously paid management fees that the seller has paid. Acquiring a more matured portfolio also means that the underlying fund investments are closer to their exits (time when assets have to be sold), as can be seen in Figure 5 below.

Figure 5: The typical private equity J-curve



The attractiveness of secondaries for investors (sellers)

Sales of private equity funds are mostly driven by the strategic needs of the seller and not the quality of the manager or the portfolio. In fact, most secondary transactions internationally have been driven by banks and insurance companies that have decided that primary private equity fund commitments are no longer core to their business and/or due to onerous regulatory capital requirements on these investments.

Some of the most common reasons for investors selling their fund commitments include:

- Change in institutional strategy away from private equity (i.e. selling of non-core businesses/investments);
- Unable to fund undrawn commitments or want to utilise future funds for something else;
- Demand for current cash and/or a view to realise a return on unrealised gains in the portfolio;
- Portfolio allocations need to be rebalanced (internal, macro-economic, or regulatory reasons);
- Breakdown in the relationship between parties; or
- A decision to sell stub positions or problem funds.

The current opportunity for secondaries in South Africa

In South Africa it is often challenging to source and successfully close an attractive secondary private equity fund transaction, because it requires a very specific set of skills, a dedicated team to evaluate detailed information about the existing portfolio and its underlying assets, a well-established network to source these transactions, the ability/mandate and readily available capital to act quickly to transact when such opportunities arise. Also, as mentioned earlier, secondary activity is driven mainly by three factors – primary market volume, investment structures, and active participants. Although the volume of the primary private equity market in South Africa justifies the existence of a relatively sized secondaries market, the investment structures and lack of active and sophisticated buyers largely mitigate the natural evolution of a secondaries market and the result is a classic illiquid investment.

However, over the past few years there has been some great development in this space and it seems like the domestic secondaries market is being invented by some institutions. For sellers that want to sell, finding a potential buyer is extremely difficult and because execution is also challenging, these institutions are providing the ideal solution through specialised secondary private equity funds.

Conclusion

A more active secondaries market will introduce liquidity for current investors into this asset class that has been classically labelled as illiquid, and it will not only provide optionality for current and regular investors, but also attract new investors to this asset class. Specialised secondary private equity funds will not only be beneficial for its investors, but will also have a significant long-term positive impact on the industry as a whole, paving the way for increased interest to private equity as an asset class in South Africa.

Transactors Talk



by **Tshego Sefolo**
CEO: Agile Capital

Tell us a bit about Agile Capital

TS: 2018 Agile Capital was launched in 2015 as a result of a management-buy out. The name means 'to build' in Tswana and in English defines agility and speed.

Agile Capital actively targets investments that offer the ability to assert meaningful change. We deliberately pursue opportunities across diverse sectors and consequently hold a broad portfolio spanning a wide range of industries. We specifically seek out businesses offering tangible growth potential coupled with solid operational track record.

As an on-balance sheet investor we do not have pressure to exit our investments which enables us to forge long-term partnerships, thereby generating superior returns. We really look to invest with organisations that have the same inherent 'DNA'. You need to be involved or alternatively partner with trusted associates.

What have been some of your highlights in the past year or two?

TS: We have invested aggressively in the specialised environmental management sector. We think that with increased consciousness towards the environment, this will prove to be compelling.

Additionally, we are particularly interested in challenging misperceptions of BEE. We believe that there is real value in BEE partnerships, but it means really doing your homework and making sure that you find the right partners. It's absolutely critical.

With the mining sector being one of the largest employers in South Africa, Agile Capital acquired a substantial share within market leader Bluhm Burton Engineering (Pty) Ltd, in a noteworthy BEE transaction.

Agile Capital acquired a significant holding in local catering and facilities management service provider,

Feedem. We partnered with RMB Corvest, and see this as a platform deal to build a bigger soft services business. Through this transaction Feedem will be owned by Agile Capital, our partner and the management team with the founders holding a residual share in the business.


Lastly, in line with our proven investment approach of backing robust management teams, we have increased our shareholdings substantially in the businesses of Provest Holdings, Provantage Media Group and Acquatico Laboratories.

What can we expect from Agile Capital in future?

TS: Our goal is to build a significant investment company with interests in diversified sectors. We want to partner with strong management teams for long-term growth. That's where our interests lie.

We'd also like to explore the role that Agile Capital can play in a South African growth context. The concept of Empowerment is maturing and additionally we see our role as an enabler in this important part of the economy. We are trying to ensure that the businesses we partner with truly are making a difference.

Our current fund is significantly invested. We are in the process of executing a transaction in the specialised services industry, subsequent to which, our fund will be substantially invested. Parallel to this, we are at advanced stages of securing our next pool of funding which will position us well for our next phase of growth.

Our existing portfolio also boasts some assets which are relatively matured, having been acquired in our first fund. Whilst we are not under pressure to exit these investment, we continuously explore ways to maximise value for our shareholders. 



SAVCA: All grown up – the joys and growing pains of private equity

by **Alton Solomons**
CEO: Sanlam Private Equity



Drawing on his experience in both spheres, the author, a father of a 12-year-old son and an 8-year-old daughter, draws some striking parallels between parenthood and being active in the private equity industry.

As we celebrate 20 years of SAVCA and this remarkable milestone, it made me sit back and reflect on the association and in particular the industry's journey and how it relates to parenthood. Like a relationship between parent and child who were born in different eras and have different ways of communicating, private equity is also often misunderstood by role players outside the industry. This creates fertile breeding ground for the development of half-truths, perceptions, assumptions, rumours; most of which cast the industry in a negative light. In the eyes of a child the parents just don't understand them, while in the eyes of the parents the child doesn't appreciate what they do and the sacrifices they make. While it will no doubt take some time and effort to change perceptions and "educate" people on the asset class, here is my attempt at shedding some light on the private equity industry through the lens of parenthood.

1. Consummating a transaction takes time

Most of the time planned parenthood doesn't happen overnight and there are a lot of variables that need to align similar to when a private equity transaction is carried out. A typical private equity transaction can take anywhere between six to 18 months to implement. A lot of time and effort is spent on identifying an investment opportunity, selecting the right partners for the investment (co-investors, advisors, funders, etc.), performing extensive due diligences, negotiating legal and commercial terms before agreements are signed and eventually the cash is released.

2. It is both a monetary and emotional investment

Any parent will tell you that to raise kids you'll inevitably experience a constant outflow of cash – and it's emotionally

demanding too. While on the surface private equity investing is purely about investing money, what is less obvious is how much the professionals, who put together and bring private equity transactions to fruition, invest emotionally too. Dealmakers treat their transactions as their "babies" from origination through to exit, and they take the performance of the investments extremely personally.

We get intimately involved in the businesses we invest in and, as a result, feel the pain when things don't work out as anticipated. But we also experience exhilaration when the value in the business is successfully unlocked. The wellbeing of investee companies is *always* at the back of your mind because you actively and constantly try to make choices that are of benefit to the investment – or at the very least, are not detrimental to it.

3. Change is a constant

No matter how detailed your "roadmap" for your child is, things never quite turn out as planned. This calls for flexibility, tenacity and extreme patience. Investing in private equity is no different. You can do the most extensive due diligence, draw up watertight transaction agreements and structures and the most detailed post-investment plan, but it inevitably does not cover every eventuality. There are always external factors that are not within your control, be it a change in legislation, the start of another economic meltdown or far-reaching developments in the socio-political landscape. The best you can do is to remain close to the business, employ the right management teams who are capable of handling these surprises and ensuring that the businesses are robust enough to withstand adversity and are agile enough to adapt to change. ►

4. Tough love is required

Remember how often you have to tell your kids what they can and can't, should and shouldn't do, often with mixed results? Well, managing private equity assets requires an equally delicate mix of guidance and advice, as well as implementing unpopular decisions and interventions for the good of the business. These include not agreeing to all of the grand growth plans management proposes and implementing strict cost-cutting measures, as well as introducing and applying unpopular punitive measures when faced with underperformance or wrongdoing. In extreme cases, such measures could result in your having to part ways with management teams you invested in or closing down parts of a business.

5. Targeting economic and social returns

Most parents want their children to be successful in their education, careers and wealth creation but equally want them to become positive change agents in the community. The success of any one of these two targets is almost always dependent on, or as a result of, the success of the other. Participants in the private equity industry, despite often having been painted as ruthless corporate raiders and financial engineers, have long realised that for businesses to make good economic returns, acting as responsible corporate citizens is non-negotiable. As part of our active hands-on investment style, we focus on Environmental, Social and Governance (ESG) considerations, both at the due diligence stage, as well as during the post-investment management stage of the transaction.

6. 'It takes a village...'


The old adage that "it takes a village to raise a child" is as applicable to making a successful investment in the private equity industry. No single private equity manager, management team, board of directors or any

other stakeholder can claim sole credit for the success of a business. Our whole industry is premised on the efficient working together of people with vastly different skills and attributes, from the lawyers and advisors to the shareholders right down to the employees of the business, everyone needs to share a common goal for a business to be successful. On the flip side, ending up with an errant child or underperforming investment is hardly ever the fault of any single person, but more likely wrongdoing, negligence or incompetence on the part of more than one party. So we select our partners and stakeholders very carefully to try and improve our chances of success.

Similarly, parenting is never a one- or two-person job, but includes grandparents and other family members, teachers, health professionals, coaches, nannies and friends, to name but a few. All of these role players can have a defining impact (negative or positive) on your child.

7. It's for life

Lastly, any parent will be able to attest to the fact that you never stop being a parent. It is truly a lifelong commitment and you never stop worrying about their challenges and revelling in their successes, even after they leave the nest. Most private equity dealmakers keep track of the investments they have been involved in long after they have exited. We reminisce about the good times, share war stories and always keep a lookout for any developments around transactions we have done. Out of sight, but never out of mind!

While both raising a child and bringing private equity transactions into fruition can be challenging at times, it is important to keep the reason for embarking on these transformative journeys top of mind – the fulfilment you experience when your child – literally and figuratively – grows up and starts changing the world in their own way. 

Note: This article was originally published in an international magazine and adapted for this publication.

Deal Tracker | Technology and Business Services

PE Fund Vumela Fund, managed by Edge Growth
Target company Mobenzi
Industry SaaS
Deal value R16 million
% shareholding taken Not disclosed
Date April 2017

Comment

Mobenzi was founded in 2009 by Friedman and Pete Fowles, who developed a suite of products which include a range of flexible mobile apps and software-as-a-service (SaaS) platforms. This suit can rapidly be configured to apply to a variety of sectors. Mobenzi's platform is aimed at those who work directly with customers and enables mobile interactions such as data collection and case management in, for e.g. the community health worker market. Mobenzi's software solutions are a powerful enabler for job creation.

PE Fund Sanari Capital
Target company Fernridge Solutions
Industry Business Services / Data Analytics
Deal value Undisclosed
% shareholding taken 51%
Date March 2017

Comment

Fernridge is a leading geo-spatial data and solutions provider, offering expert insights to inform location-based business decisions.

Clients include retailers, property developers, private equity investors, and service providers in the financial, health care, education and public sectors.

Sanari's investment thesis was to leverage and expand Fernridge's proprietary data set and blue chip customer base for added insights and profitable growth, capitalise on Fernridge's Level 2 B-BBEE credentials and tap growth through regional expansion, product line extension, new applications/industry verticals and the new web platform.

Impact investing: Social benefits and competitive returns not mutually exclusive



In South Africa, there are countless opportunities to make a difference, including by boosting broad-based black economic empowerment by fostering the development of small businesses and creating jobs. While impact funds' primary focus is social development and sustainability, they also cannot neglect their duty to their investors.

Impact investing – which seeks to effect positive social and environmental change alongside profits – is entering the mainstream as a growing number of private equity stakeholders recognise the importance of doing business sustainably.

A recent report by EY notes that while in the past impact funds might have prioritised social benefits over financial performance, a new generation of managers “are adamant that returns can be comparable to, or better than, other non-impact investments”.

Some global private equity houses have recently raised impact funds – one of the most notable being TPG's \$2 billion The Rise Fund, which aims to achieve social and environmental impact together with attractive financial returns.

Impact investing is also becoming more prominent in South Africa. One of the drivers of the asset class is the enterprise and supplier development (ESD) requirements of the broad-based black economic empowerment (B-BBEE) codes of good practice, which are incentivising companies to invest in the development of black-owned small businesses and job creation. For instance, Edge Growth manages the R388 million Vumela Enterprise Development Fund, which is the primary ESD vehicle for financial services group FirstRand. The fund has invested in businesses such as on-demand home cleaning services platform SweepSouth; the largest South African email service provider Everlytic; and Brand Incentives, pioneers of scent marketing in South Africa.

Another impact investment firm using B-BBEE legislation to catalyse social impact is the Johannesburg-based Awethu

Project, which manages AB InBev's R300 million Supplier Development Fund, the SAB Thrive Fund, and similar sister funds for Imperial Logistics and Impala Platinum. Awethu has a mission to reduce inequality through entrepreneurship. It runs a micro-cap private equity fund management business that increases the participation of black entrepreneurs in corporate supply chains, using a high-volume but low-cost transaction model.

Rob LeBlanc, Awethu Project's chief investment officer, says there are different interpretations of impact investing. On the one end of the spectrum are firms that believe by just creating employment and paying taxes they are having a positive impact, while on the other end there are donor-funded organisations focused purely on social and environmental change with no profit motive. He explains that although having an impact is what gets the Awethu team out of bed in the morning, the firm still aims to deliver similar returns to traditional private equity to ultimately attract more capital for impact. LeBlanc's definition of impact investing is, “When the ‘why’ comes first, not returns. The impact drives the model, it isn't a nice-to-have.”



Rob LeBlanc



Stuart Bradley

Stuart Bradley, joint managing partner of Phatisa, agrees there isn't consensus about the definition of “impact”, which is why his firm prefers the term “development equity”. Phatisa, through its African Agriculture Fund (AAF), has invested in a Zambian poultry business, two agricultural ►



equipment suppliers, and a large fertiliser distribution company, to name a few transactions. Phatisa also raised a \$15 million technical assistance facility from the European Union, among others, to further drive impact with no cost to the fund. The AAF seeks to boost food security and build sustainable communities, while ensuring the best possible returns for investors.

Graham Stokoe, Africa private equity leader at EY, argues that although private equity fund managers on the continent have traditionally had a stronger environmental, social and governance (ESG) agenda than their developed-world counterparts (due to the influence of development



Graham Stokoe

finance institutions), firms are increasingly "realising that with impact investing you are not sacrificing earnings, but that you can actually deliver better financial returns by developing and scaling sustainable businesses that have a significant impact on the communities served – be it through customers, employers, suppliers, shareholders and other stakeholders".

He adds that Section 12J of South Africa's Income Tax Act, which allows taxpayers to deduct 100% of their investment in approved venture capital (VC) companies from taxable income, have seen the proliferation of VC funds, many which have impact motives.

Deal-making

When it comes to investing, South Africa's impact funds typically don't target social enterprises per se, but rather traditional businesses with the ability to deliver on a fund's impact mandate.

"The social impact actually comes through buying a simple asset, and using that business to integrate previously excluded talent, transfer skills and create wealth for black South Africans," explains LeBlanc.

Richard Rose, head of Edge Growth's Vumela fund, says 2017 has been a successful year from an investment perspective, with the firm deploying a record amount of capital. However, he notes it is sometimes tough to find suitable entrepreneurs, especially for funds with narrow mandates. There is also greater competition for deals, particularly for technology-enabled businesses.



Richard Rose

He adds that investors are seeking greater value for money from their ESD commitments. "Whereas in the past corporates would support businesses outside their supply chain, there is now a greater focus on leveraging these investments to build their own black-owned supply chains and to create value for shareholders."

Edge Growth has started an in-house acceleration programme to train its entrepreneurs in disciplines such as building a team, crafting a winning strategy, developing a high-performance culture, and financial management. "We are investing in more risky businesses that are earlier in their life, and they typically require a little bit more support," explains Rose.


Fund raising

South African impact funds haven't been spared from the country's lacklustre economic growth, estimated at 0.3% and 0.7% in 2016 and 2017 respectively; political uncertainty in the run-up to the ruling ANC's elective conference at the end of last year; and sharp fluctuations in the value of the local currency.

"It certainly makes conversations with investors harder," commented one industry player.

Another fund raising challenge is that due to the nebulous nature of the asset class, limited partners (LPs) sometimes have trouble assessing a fund's impact. While one would expect that a social mandate, on top of competitive financial returns, would be a deal sweetener, in actual fact it can add a level of complexity. LPs understand a 20% financial return, but they often have difficulty getting to grips with what exactly constitutes meaningful job creation or environmental impacts.

Bradley says impact funds that neglect financial performance are going to struggle to attract capital. Even development finance institutions seek a decent financial return, alongside their social impact requirements. "If we are not offering our investors a return comparable to more traditional private equity firms, we are going to have a tough time raising money."

But there's no doubt the world has changed, with LPs demanding that general partners pay attention to their social and development impact. "At the end of the day pension funds need to make money for their pensioners, but they also need to ensure there's a world left for their pensioners to live in. So, there has definitely been a mindset shift," notes Bradley. 

Q&A Fund raising: A GP's perspective



SAVCA speaks to Founding Partner of Kleoss Capital, Zain Laher (ZL), and Head of Edge Growth Vumela Fund, Richard Rose (RR), on how they find the fundraising environment.

How would you describe the current fund raising environment in the Southern African region or across Africa?

ZL: Kleoss Capital is a South African mid-market private equity fund manager that was established in 2014. From Kleoss Capital's perspective, the current fund raising environment for private equity fund managers in South Africa appears to be quite favorable. While South African private equity fund managers have been subject to a low growth economic environment, volatile exchange rates, currency depreciation and a challenging political environment in recent years that has contributed to a diversion of a significant amount of international private equity funds from South Africa and into other more attractive markets, there remains a strong and growing pool of capital available for investment from South African investors. As a Level 1 accredited B-BBEE fund manager, Kleoss Capital also benefits from increasing allocations to B-BBEE fund managers.



Zain Laher

RR: The environment has certainly been challenging over the past six months that we've been in the market with the



Richard Rose

Edge Venture Fund. In particular, foreign investors are cautious around the political environment and the potential impact of further devaluations of the rand, which has significantly impacted their home currency-based returns over the last 5-8 years.

Has fund raising become easier or more challenging as compared to previous years?


ZL: From my experience, fund raising is not ever not challenging with every private equity fund vintage and fund manager having its own set of challenges! From

Kleoss Capital's perspective, as a first time fund manager in previous years, fund raising challenges related mainly to 'first-time fund manager' risks. Other challenges at the time included the fact that Kleoss was a South Africa only fund manager with a lot of fund managers looking for some level of fund allocation to sub-Saharan Africa. Recently we have noticed a renewed interest and preference for single country/regional focused funds.

RR: A general slump in economic growth and slowdown in business confidence has certainly made LPs think longer and harder around committing their capital to a private equity fund and being locked up for 10 years.

What can the private equity industry expect from fund raising activities in the region in the future?

ZL: I expect there to be more fund managers coming into the market in future years. While a strong record of previous performance and demonstrated success in all the areas of private equity is a pre-requisite (deal origination, value add and growth, exit etc.) for a successful fund raise, with increased choice for deployment of their capital, I expect investors to place a premium on and to favour fund managers that are able to truly demonstrate differentiation accompanied with innovative value adding strategies. There will also be increased allocations to new and emerging empowered fund managers and I expect the trend of PCVs and hybrid structures to continue.

RR: The results of the ANC elective conference will hopefully provide a platform from which the country can begin rebuilding its economy and improve the outlook for long term investors. However, I expect progress in this direction to be slow and take time to have a material impact on fund raising activities. 

Developing new fund managers



What is the significance of developing new fund managers in the Southern African private equity industry?

RO: South Africa is lucky to have a fairly well developed and long standing private equity industry and ecosystem, as well as a history of good returns for investors. However, without new fund managers, and particularly individuals from different backgrounds and cultures, the industry will not grow to its potential, and will miss many opportunities. The entry of new blood has the added benefit of keeping the more established players on their toes and as sharp as possible as they compete with the new entrants for capital and deals. But most importantly, all industries in South Africa should reflect the demographics of the country if we are to have a sustainable society, and private equity is no exception.

Historically, what have been the challenges in transforming the private equity industry?

RO: New fund managers tend not to be private equity novices. They have normally worked in private equity in some capacity or another, so for example they may be strong dealmakers, but they may not know how to approach fund raising or investor relations. Another big difficulty is the length of the fund raising cycle, and the challenge of supporting a team through this period without income from management fees. But the largest challenge is how to convince investors to back a first-time team when there are well-established industry incumbents. This is something we have looked at closely in our investment process, examining how we should adapt to make sure we are not excluding good managers just because they have not been in the field as long as others.

A local perspective

by Rory Ord

Head of Unlisted Investments:
27four Investment Managers



How do you see the transformation agenda changing in the private equity industry going forward?

RO: The face of South African private equity is still pale and male, but some progress has been made. There are now at least 20 general partners (GPs) in our universe of managers meeting the definition of Black Private Equity (PE) Funds, and several are already on their second or third fund. There are unfortunately very few institutional investors with ongoing private equity allocations, meaning that the same institutions back all PE funds in the country. Ideally, we would want to see more allocations to PE in general, but in the absence of this, more conscious allocations to support black fund managers. This is starting to happen from funds such as the Telkom Retirement Fund, which has backed the Black Business Growth Fund to begin to address transformation.

How is 27four Investment Managers contributing to changing the transformation narrative in the Southern African private equity industry?

RO: 27four has set up the Black Business Growth Fund (BBGF), a fund of black private equity funds focused on investing in South Africa. The BBGF is the first fund to give investors access to excellent growth opportunities in unlisted South African companies while transforming the private equity fund management industry and supporting black investment managers and black-owned and -managed companies.

The BBGF will provide vital funding to new and established black managers, allowing them to demonstrate their skills and build their track records. We believe there are excellent opportunities in the market for these managers, and we expect strong returns. The fund did its first close in December 2017, and is seeing demand from institutional investors looking to diversify their SA equity exposure and achieve excess returns while supporting transformation of the financial sector and the South African economy as a whole. ►



An international perspective

by **Randy Mitchell**

Vice President of Strategic Engagement:
EMPEA

What is the significance of developing new fund managers, especially in emerging markets?

RM: A vibrant indigenous private capital ecosystem is essential for catalysing economic growth and diversification. Not only so that local investors have valuable in-market perspective when sourcing deal flow, they are also well-positioned to add value to the funded portfolio companies as they form, grow and accelerate their ventures. In addition, the presence of qualified local investors and fund managers catalyses capital inflows from international investors and strategic partners.

However, in many emerging markets, there is deficiency of local private capital investors across the entire spectrum: from business angels to equity fund managers.

In order to develop that local investor capacity in emerging markets, it is crucial to support first-time fund managers. In addition to their critical role in the ecosystem, the newly established funds (1-3) are often producing greater returns for institutional limited partner (LP) investors.

What has been the historic challenge in transforming the private equity industry in emerging markets? How are other emerging markets tackling this challenge?

RM: The private equity industry can only exist in the context of a free-market economy. Emerging markets are still in the process of developing the necessary legal, regulatory and business environment, and supportive market structures. In addition, the culture of private capital investing is oftentimes quite nascent, if existent at all. Most emerging market companies rely on bank loans or where available government support including grants to fuel their formation and growth. This situation is not conducive to innovation and technology-powered entrepreneurship, hence the need for investors who would provide sufficient private capital in exchange for equity.

Ideally, such equity investors would also provide business expertise, linkages and other support to increase the value of their investment and facilitate lucrative exit down the road. This is why it is important to have local equity investors, such as venture fund managers and business angels, who have intimate knowledge of the local business environments, can provide ongoing support and oversight, and – if necessary – facilitate linkages with other investors and strategic partners.

In the developed economies, it took decades for the private equity ecosystem to emerge and become the lifeblood of innovation and entrepreneurship that it is today. The emerging markets do not have comparable accumulated institutional knowledge, experience and capacity, yet. So, where do we start?

As a case study, we can look at the emergence of private equity industry in the United States and Europe. In the late

1950s, the United States created the Small Business Investment Company Act (SBIC). The creation of SBIC fund managers was seen as the spark that brought about the private equity and venture capital industries. Private equity was further transformed in 1978 in the United States when public pensions were permitted to allocate a “prudent” amount into alternative assets such as private equity.

In Europe, the European Investment Fund (EIF) has been integral in kick-starting fund investments and encouraging private capital to enter the market via emerging fund managers.

In each of these cases there was significant carefully considered government intervention. Both the SBIC and the EIF continue today. In the case of the SBIC, it is not a drain on the US government budget, rather it returns money to the US Treasury.

So, a historic challenge has been creating a stimulating environment and support for fund managers to organise themselves, step forward to take risk, and begin funding emerging and growing enterprises. The examples shared here were of developed markets, but these initiatives were the start of the private equity and or venture capital industry in these two large developed markets. There are lessons here for emerging economy governments.

Government intervention would, however, not always result in a perfect solution. In fact, there have been attempts by some governments in developed and developing economies that resulted in market distortion and failure to stimulate creation of sustainable private equity industry (for a detailed analysis, see Josh Lerner’s book, *Boulevard(s) of Broken Dreams*).

This is why it is critically important to engage stakeholders from the business, finance and government sectors in developing and implementing private capital investment ecosystem initiatives which should be market-driven and evidence-based.

In summary, in order to create their own private equity and venture capital investing ecosystems, the emerging markets in general and the Southern African markets in particular need to create and maintain a conducive business and regulatory environment; promote the culture of equity investing across all market segments, including SMEs, universities, industry and economic development institutions; facilitate investor skills development training for aspiring fund managers and other investors; support information and best-practices exchange, networking, inter-regional and global collaboration. Professional associations, such as SAVCA, play an important role in this effort. 



Mezzanine debt in South Africa – An attractive proposition for investors

by **Ashley Benatar**

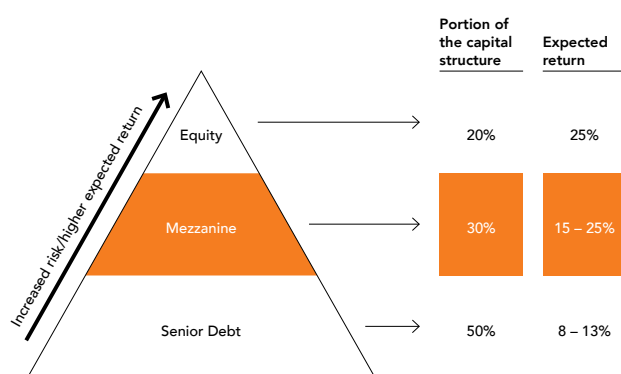
Head of Mezzanine Finance: Ashburton Investments



Mezzanine finance is still in its infancy in South Africa compared to developed markets, but this asset class nevertheless offers investors attractive risk adjusted returns. Despite the local low growth environment, it is anticipated that certain sectors will offer ample mezzanine financing opportunities in the near future.

What is mezzanine debt?

Mezzanine debt sits between the equity and the senior debt in the capital structure. In the event of default, the mezzanine funder ranks behind the senior lenders but ahead of the equity providers. Given the mezzanine investment's position in the capital structure, it targets equity-like returns with debt-like risk. The debt-like risk is achieved through the downside protection afforded by its superior ranking relative to the equity investors as well as contractual and other rights that are associated with debt instruments, including financial covenants, step-in rights and security in the form of tangible assets, debtors and shares.



Equity-like returns of between 15% and 25% are achieved through a combination of contractual interest, roll-up interest and equity participation. Interest rates in South Africa are currently close to their all-time lows given the low economic growth environment. Accordingly, it is becoming increasingly difficult for investors to achieve additional yield without assuming greater risk, and mezzanine financing offers investors attractive risk adjusted returns when compared to private equity or senior debt. Mezzanine financing offers higher yields than senior debt with less

volatility than private equity. In this article, we will discuss the various features of mezzanine debt that makes it an attractive risk adjusted investment in the current economic environment.

Mezzanine debt returns compared to private equity and senior debt returns in a low growth environment

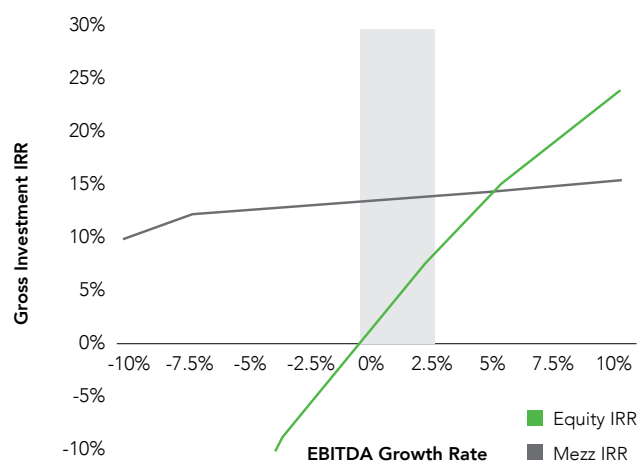
Private Equity

Until the start of the Global Financial Crisis, private equity in South Africa offered tremendous returns given the gross domestic product (GDP) growth and the expansion of South African corporates into other growing regions on the continent. This, coupled with the availability of credit and increase in company multiples, made private equity returns very appealing to investors.

In the current market environment of low GDP growth, poor economic fundamentals, high unemployment rates, increased taxes and multiple contraction being prevalent in South Africa, we believe that an investment into a mezzanine fund will offer better risk-adjusted returns than an investment into a private equity fund that does not offer vintage diversification. A mezzanine investment in the current time frame should however be complementary to an existing private equity portfolio that spans across various vintages because it would enhance the portfolio's expected risk adjusted return outcome.

A 2013 study by Sankaty Advisors LLC, shows that in an environment of low growth and volatile public markets, mezzanine is less affected than private equity and is more resilient than other asset classes. Although this study focused on the US Middle Market, its findings are also relevant to the South African market, especially given the current low economic growth outlook coupled with lacklustre listed equity returns. ►

Figure 1: Hypothetical mezzanine and private equity return profile



Because mezzanine is senior in the capital structure to private equity and generates a cash yield, its returns are less sensitive to earnings before interest, taxes, depreciation and amortisation (EBITDA) growth. Figure 1 above shows that in a low 0% – 2.5% growth environment mezzanine returns are more stable at 13% – 14% internal rate of return (IRR), while private equity returns are more volatile at 0% – 7% ¹.

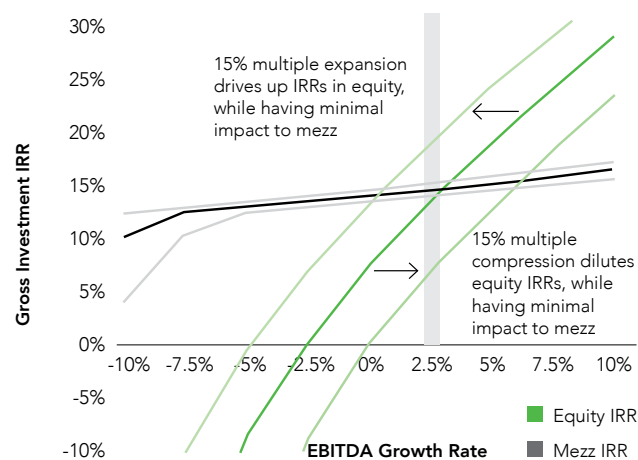
Comparative IRRs

Base case (flat entry and exit multiples)

EBITDA growth rate	0%	2.5%
Mezzanine debt	13%	14%
Private equity	0%	7%

Source: Sankaty Analysis, CEPRES, LSTA

Figure 2: Mezzanine and private equity return profile – impact of multiple expansion/compression



Comparative IRRs

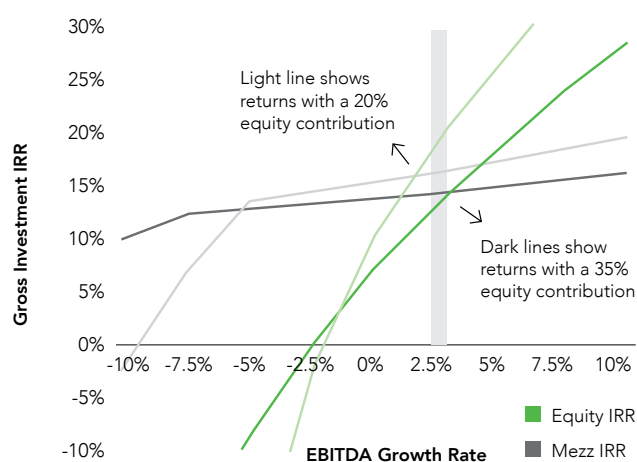
-15% exit multiple contraction

EBITDA growth rate	0%	2.5%
Mezzanine debt	13%	14%
Private equity	7%	13%

Source: Sankaty Analysis, CEPRES, LSTA

Second, mezzanine is only marginally affected by multiple contraction/expansion. Multiple expansion occurs when a

Figure 3: Mezzanine and private equity return profile – lower equity contributions



Comparative IRRs

Increase in equity contribution from 20% to 35%

EBITDA growth rate	0%	2.5%
Mezzanine debt	13%	14%
Private equity	7%	13%

Source: Sankaty Analysis, CEPRES, LSTA

Third, senior lenders now require the sponsors to write larger equity contributions. This provides a better cushion ▶

¹Assumptions in Figures 1-3: Capital structure is 40% senior debt, 25% mezzanine debt, and 35% equity. Mezzanine interest rate is 15% being 11% and 4% PIK.

for mezzanine investors, but it also compresses the private equity returns. Figure 3 above shows how private equity and mezzanine returns are affected when the equity contribution is increased from 20% to 35%. Assuming a 2.5% EBITDA growth rate, private equity returns reduce meaningfully from a 19% IRR to a 13% IRR while the mezzanine returns reduce from 16% IRR to 14% IRR.

Lastly, the self-liquidating equity kickers also provide mezzanine debt investors with a definitive exit path as it has a set maturity date, which makes mezzanine appealing compared to private equity that is reliant on a sale or an initial public offering (IPO), which can be difficult in the current economic environment in which EBITDA multiples are contracting. At such a point in time, it could also be difficult for a private equity investor to find a trade buyer and hence their options for exit might be limited. It is important to remember that a private equity manager has the obligation to establish an exit for its investments before cash returns can be paid back to investors. Mezzanine therefore offers advantages when it comes to timely cash repayment of returns to investors.

Senior debt

Mezzanine debt investments are compelling compared to senior debt for two main reasons. First, mezzanine debt offers a higher return, typically between 15% – 25%, compared to senior debt returns of 10% – 13%, which is an attractive premium for the higher complexity and leverage in the underlying transactions. Second, mezzanine investors can exercise a lot more control over the investment than senior debt investors.

A senior debt investment is generally syndicated among several investors whereas in a mezzanine debt investment the investor usually controls the mezzanine layer. The investor also takes an active role in monitoring the investment and generally has observer status or directorship on the portfolio company's board. This allows the mezzanine debt investor greater information rights, which include monthly management accounts and reports, participation at board meetings and access to management.

Furthermore, the tight covenants enforced on the company provides the investor with early warning signals of potential defaults and allows for early decisions to preserve their investments.

Thus, while default rates on mezzanine investments are higher than those of senior debt investments, when there is a default on a mezzanine investment, investors in many instances recover a larger proportion of the investment than when there is a default on a senior loan². Importantly this loss ratio would be applied to a 15% – 25% return range for mezzanine debt investments relative to a 10% – 13% return for senior debt.

An investment in mezzanine should therefore not be seen in isolation but complimentary to an investor's existing senior debt portfolio as it positively adds additional diversification, which improves the investor's risk adjusted return portfolio profile.

Attractiveness to borrowers

Access to finance is one of the most prevalent challenges faced by mid-market companies in South Africa with banks typically focused on larger corporates. Additionally, the global financial crisis and introduction of capital adequacy requirements have resulted in many banks reducing their exposure to mezzanine debt. While private equity is one viable option, entrepreneurs are sometimes hesitant to go this route due to a reluctance to give up equity. Mezzanine debt on the other hand is attractive to companies requiring capital because it is more flexible than senior debt and avoids the significant equity dilution which accompanies traditional private equity.

For black economic empowerment (BEE) investments, management and leverage buy-outs, and private equity acquisitions, mezzanine debt can also be utilised to reduce equity contributions required by the sponsor, thereby enhancing their returns. Mezzanine debt is often the most appropriate form of finance for companies looking to expand existing operations or to fund new acquisitions, or by shareholders to acquire equity in a company, or to do a leveraged recapitalisation. Mezzanine debt is ►

Mezzanine debt also allows a company to boost its absolute profit and return on equity as well as reduce its cost of capital as one can see from the example below:

	Cost of capital	Capital structure including mezzanine debt	Capital structure without mezzanine debt	Capital structure without debt
Senior debt	10%	50%	50%	0%
Mezzanine debt	15%	30%	0%	0%
Equity	25%	20%	50%	100%
Weighted average cost of capital		14.50%	17.50%	25%

further beneficial to the owners because it does not require management control, and with predefined exit arrangements, it avoids conflicting shareholder exit agendas. Mezzanine debt is therefore used by borrowers in various situations and is not a financial tool that is only viable in a set economic environment or type of transaction. This is also particularly useful to the mezzanine investor when constructing a portfolio of mezzanine loans as not only can one craft a diverse industry and company portfolio but the intended use can also be diverse, as one can for example focus on constructing a portfolio of BEE investments, growth capital and acquisition finance transactions.

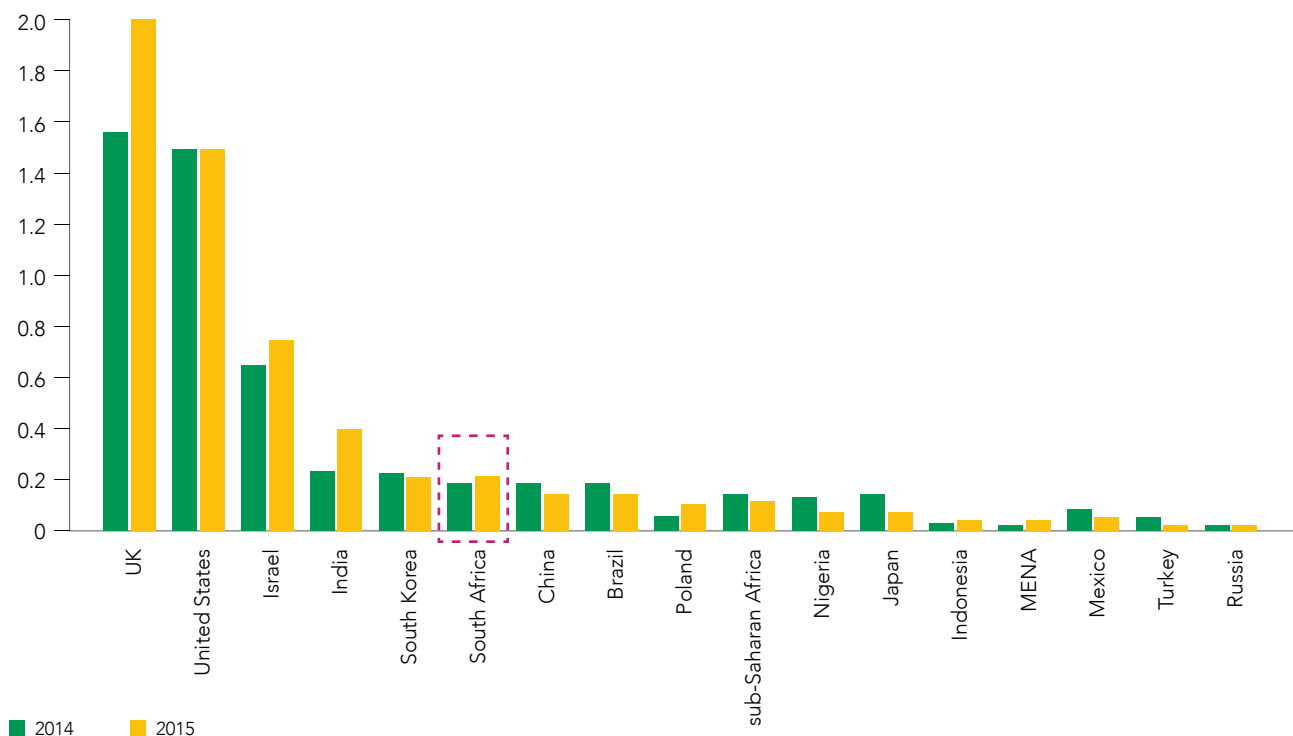
Mezzanine in South Africa

Mezzanine finance in South Africa is still in its infancy when compared to the developed markets and there are very few dedicated mezzanine fund managers with capital to invest. This is compounded by the fact that the credit, capital and private equity markets are also still developing. Per the Emerging Markets Private Equity Association (EMPEA), global capital penetration as a percentage of GDP in South Africa was 0.26%, compared to the 1.81%

for the UK and 1.54% for the US in 2015. Additionally, as at 31 December 2016, there was only R1.2 billion of undrawn commitments available by mezzanine funds in South Africa.

While on a macro level South Africa is forecasting low growth, Ashburton Mezzanine anticipates that certain sectors will provide ample mezzanine financing opportunities. These include the large number of BEE transactions that will require funding with the implementation of the new broad-based black economic empowerment (B-BBEE) codes. Additionally, mezzanine funding opportunities exist for mid-market companies looking to fund growth, acquisitions or recapitalisations where the funding can be tailor-made to each company's specific needs without the dilutionary effect of private equity. In renewable energy transactions, which have been growing rapidly over the past five years, mezzanine financing can help strengthen a project's equity profile because of its flexibility compared to senior debt finance. Mezzanine finance is also attractive as it can lower the cost of financing a project compared to pure equity financing. Mezzanine financing into infrastructure is attractive due to the stability of infrastructure assets through changing macro and credit conditions. [🔗](#)

Global private capital penetration / GDP (%)



Source: EMPEA Q3 Industry Statistics

² A Default rates over a 15-year period in Bain Credit's mezzanine portfolio was 8.2% versus 3.4% default in their High Yield portfolio, however defaults in the mezzanine portfolio recovered 94 cents on each dollar defaulted versus 39 cents for High Yield over the same period.



Fund raising: LP perspective

by Juan Coetzer

Head of Private Equity: Ashburton Investments

How has the fund raising landscape changed the past few years from an LP perspective?


Fund raising in South Africa has been and remains challenging even for the most reputable private equity firms in the country. Increased interest and movements towards permanent capital vehicles by some, reflects the challenging domestic fund raising environment. Obviously, things like transformation, foreign currency challenges and its effects on carried interest pools, undesired time-pressure to invest/exit deals, are also playing a role in desiring permanent capital. But it is not that easy for traditional private equity fund managers to go this route, mostly due to conflict of interest with their existing investors. But, listed investment vehicles also have disadvantages like trading at a discount to NAV and negative cash-drag while capital is undeployed. Despite its challenges, I think the traditional third-party fund model is here to stay for still some time to come.

While regulation has opened up the door a few years ago for increased allocation to private equity by pension funds, uptake has been disappointing for an asset class that has continuously delivered great returns. Investors who aren't new to the asset class have continued to make regular allocations, but many pension fund investors still have not invested in private equity. With listed markets performing poorly in the last few years, some have considered allocations to private equity for the first time in their search for yield – albeit a very small part of their portfolios. The entry of a few new players in the market, such as fund-of-funds and secondary-focused funds, have played a very important role in educating and introducing the asset class to new investors. Asset consultants and industry bodies, such as SAVCA, have also been key to educate investors and highlight the advantages of including private equity into a larger portfolio of traditional investments. These combined efforts, coupled with continued good performance by general partners (GPs) should attract new and increased allocations over the next few years.

Considering the GPs that have recently been successful in fund raising, what can their colleagues or peers learn from their approach?

Persistence is a good quality to have, but not knowing where to draw the line can easily shut the door very quickly. Successful fund raising is not only about track record and experience, it's also a function of team composition, good relationships, ability to demonstrate capability, institutional memory and trust. While I don't think there is a single winning formula, a successful and experienced past in private equity, hungry individuals with everything on the line, non-stop energy, respect for time, charming personalities and a humble approach could go a long way.

How can GPs best position themselves to LPs when fund raising in the future?

It depends who the investor is, everyone is different so do the homework and prepare properly for every meeting. Sophisticated investors will see beyond the pretty pictures and charming personalities. Quality of content is important and should clearly illustrate what investors should and want to know, including past successes and failures. GPs should be able to repeat past successes and demonstrate how, and what sets them apart from the rest. LPs appreciate an honest and transparent discussion about things that have not worked in the past and how a GP has dealt with those situations and will avoid it in future. If these mistakes or losses were small enough for a GP to still be around, it's institutional memory paid for by prior investors and priceless for new investors. Don't take interruptions personally – LPs and asset consultants listen to many proposals and often just try and manage their time. To prevent lengthy and expensive legal negotiation processes, a GP should carefully manage them and try keep negotiations between principals where possible. 



Why didn't you call earlier?

by Paul Birkett

Executive Director: ASOC Management Company



It is vital that owners and directors of companies seek help as soon as they suspect their ventures are in trouble – waiting could have disastrous consequences.

Hope is a dangerous thing. Particularly when it leads us to deny a real cash flow problem exists and encourages us to forego the help we so desperately need. When it comes to denying the realities in a business, hope can be devastating, as it is not only the business owner who suffers, financially and reputationally, but also every other stakeholder in the business, including employees, communities, suppliers, financiers, among others.

Too often in our business dealings today, we come across good businesses that could have been turned around or rescued, had those in charge only made the decision to explore their options sooner. But too often, by such time, the business has passed the tipping point of no return and now it's destined to form part of the insolvency statistics.

It's not a new lament amongst restructuring professionals and turnaround investors in South Africa; the recent Deloitte Restructuring Survey Results evidenced that early identification of financial distress is, year after year, the foremost key to a successful restructuring. So, we frequently ask directors, senior executives and business owners: "Why did you leave it so late to call?", "Why did you wait until you ran out money, and now cannot make payroll next week?" or "Why didn't you call for help last week or last month?"


We have a few theories as to why directors and senior executives are reluctant to make the call to explore their options. Perhaps they are poorly incentivised to do so; many business owners and senior executives may view their interests in a business as a call option (i.e. when things go well, they reap the upside benefits in the form of dividends or big bonuses). Unfortunately, on the other side of this coin are the employees, suppliers, communities, financiers and other stakeholders who, when the going

is good, receive a fixed return, flat margin, or set interest rate, however when the going gets tough, risk losing their investment or worse, their very livelihoods.

Perhaps the biggest deterrent to the early identification of a problem is ego. In any restructuring, ego is our biggest enemy. People's identities are so wrapped up in the businesses they work for, represent or hold interests in, that when these businesses are challenged, it takes great courage to accept responsibility and admit that bitter medicine is the best answer.

A typical psychological cycle we recognise is, first, to deny that a problem exists (hoping that it will simply go away). When the problem does indeed turn out to be real, directors, business owners, and investors become angry at the situation as they are forced to accept the truth. This is followed by depression and shame (trying to hide from the truth), and thereafter a rally as they find the courage to build a solution. This is the point at which we at ASOC can work together to find a way forward.

So, our hope, is that if you as an owner, director, senior executive have a problem (or even suspect that there may be a problem), you will make that call early and get help. Find the right professionals and get on the front foot of the problem. You have a greater duty to all stakeholders and the longer you leave it, the fewer alternatives you may have available to you. If you wait for another economic shock, another ratings downgrade, another blow-out in the currency, it may be too late.

In the words of Mike Tyson, "Everyone has a plan until they get punched in the mouth." But perhaps explore your options and find help, so at least you know where to go when that plan does get hit. 



FORESIGHT

Creating jobs through private equity



by **Sandile Dlamini**

Business Management student:
African Leadership University

While economies on the African continent boast strong growth prospects, unemployment poses a huge challenge. Research undertaken in South Africa, Kenya and Nigeria shows that private equity investment can play an important role in addressing this issue.

During the past four months, I have undertaken an independent research project to understand the role of private equity (PE) investments in job creation in South Africa, Kenya and Nigeria. I travelled to these three countries, interviewed 40 PE leaders, sat in three board meetings and attended a PE conference.

My curiosity to understand this topic stemmed from observing the population growth rate in comparison to the employment rate on the African continent and deduced the negative effects this population will experience if the current unemployment rate is sustained. Creating economic opportunities for this growing population is of paramount importance today. Adam Smith wrote in his book *The Theory of Moral Sentiments*, "All members of the society stand in need of each other's assistance, and are likewise exposed to mutual injuries." If the unemployment rate remains the same

until 2034, more than 56 million people from these three countries will be in need of jobs. The private and public sectors will need to work together in addressing this challenge.

Throughout the research, I learned that Africa is significantly underrepresented in international markets – it holds less than 1% of private capital. This is due to three major challenges, which can be categorised as political, economical and operational, and which cause a dearth of PE investments in Africa. However, Africa's long-term growth prospects are strong – with a growing workforce, rapid urbanisation, technology and natural resource endowments, the continent is a hotspot for PE investments despite the challenges.

PE in Africa has a huge potential for creating jobs that are needed in the continent. According to the African Private ▶

Figure 1: Projected unemployment increment by 2034 in South Africa, Kenya and Nigeria

	2016, Million	2034, Million	Explanation
South Africa	7	13	Low growth potential due to structural bottlenecks; political infighting that generates policy uncertainty.
Kenya	6	18	Governance standards rather low with poor rankings due to corruption and political instability .
Nigeria	9	25	The public sector revenue base is heavily biased towards oil related activities.
Total	22	56	All three countries have high immigrants influx , which will increase the number of unemployed people by 2034.

Note: Assumes that unemployment rates in each country remain unchanged: South Africa 25.4%, Kenya 39.1% and Nigeria 13.38%.

Source: McKinsey Global Institute. Emerging Markets Private Equity Association, AVCA, Preqin Private Data.

Equity and Venture Capital Association's (AVCA's) 2017 *Africa Sustainability Study*, jobs grew by +17% in PE-backed companies in Africa between 2009 to 2016 (this was from the 284 companies that participated in the survey). Two important key insights can be gleaned from AVCA's research: jobs grew faster in small companies with fewer than 300 employees and when PE firms had a majority stake of +30%.

Another important finding from my research was the need for PE firms to focus on creating growth to achieve attractive profitability returns rather than relying on financial engineering. The McKinsey *Lion on the Move II* of 2016 pointed out that there are only 400 companies in Africa making an annual revenue of \$1 billion a year and nearly 11,000 companies making an annual revenue of between \$10 million and \$100 million. This shows that investing hundreds of millions of dollars to improve a company's performance and expect it to thrive in the traditional PE time frame is not suitable in the continent.

Clearly the opportunities to invest in Africa lie in small companies that have the potential to grow quickly and become Africa's unicorns by leveraging outside capital and expertise from financial institutions. There are six sectors in Africa with faster growth and higher profitability than global average in that sector according to McKinsey *Lions on the Move II* report: health care, wholesale & retail, food & agri-processing, construction, financial services and light

manufacturing.

For PE firms to tap into this potential, they will need to abandon the one-size-fits-all model and do things differently on the African continent. This requires limited partners and general partners to work together in innovating the mandate to be tailored for African capitalism: to be long-term, focus on that local environment in which they are operating and to have a return maximisation framework for a particular environment and sector.

There are three recommendations for PE firms on how to navigate challenges, build businesses of scale to employ people and achieve risk-adjusted returns in Africa:


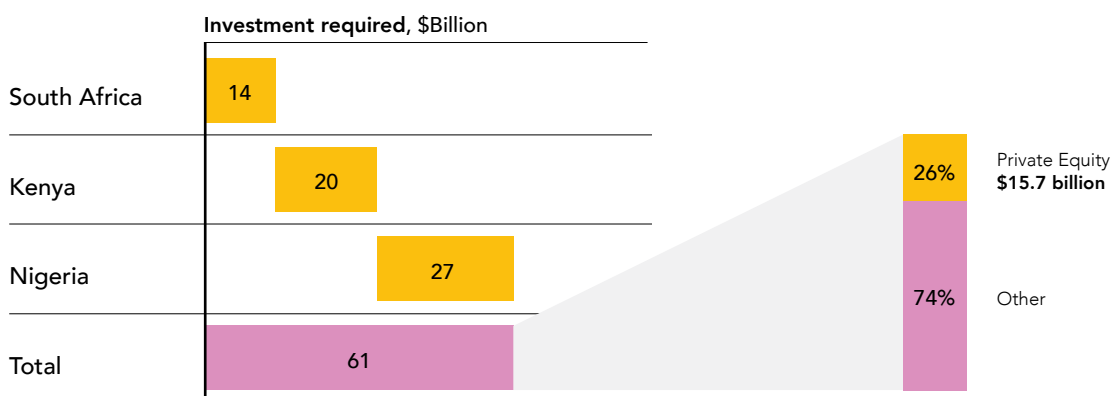
1. Have the right size of capital: Structure ticket sizes to target early stage companies in the \$10 to \$100 million annual revenue bucket.
2. Invest in scalable platforms: There is competition for a limited number of deals among PE firms. PE firms should invest in scalable platforms rather than at scale investments and also have the risk appetite to build companies where they see opportunities.
3. Engage with portfolio companies: It is important that PE firms manage their portfolio companies irrespective of whether they have majority or minority stakes. In addition, they must hire and partner with people who understand the local environment and also hire sector veterans. Lastly, hire a chief digital officer who will focus on digital disruption and transformation. 

Figure 2: Private equity investment required to close the unemployment gap



Notes: 1. Total Jobs divided by revenue multiplier for South Africa, Kenya, Nigeria, also assuming \$1 of investment for Δ\$1 revenue.
 2. Assume private equity investments continue at the same rate as they did during the previous 10 years.
 3. Numbers may not add up due to rounding.

Source: Emerging Markets Private Equity Association Private Data.

Sandile Dlamini is in the third year of his Business Management course at the African Leadership University based in Mauritius. Other than his interest in finance and business, he is interested in brokering trade between China and Africa, has worked with McKinsey in Shanghai, and speaks Mandarin Chinese. Recently, he has been exploring the role of private equity in creating jobs on the African continent – a research project where he met with industry leaders in South Africa, Kenya and Nigeria. He also graduated with the African Leadership Academy Class of 2015.



Six trends for 2018

by **Dion Chang**

Founder and CEO: Flux Trends

Across an array of sectors, from retail to biology and diplomacy, the world is changing in fundamental ways. What are some of the most relevant trends that will shape our lives in 2018 and beyond?

Using the TRENDS acronym, Flux Trends provides a glimpse into the key trends for 2018 across six sectors. These are just a sample of a broader selection of trends, which Flux explores in-depth at our annual trend presentation – *The State We're In* – that kick-starts each new year. Our 2018 edition entitled *Through a Different Lens*, is a follow-on from the 2017 edition, *Dazed and Disoriented, the impact of being WOKE*. 2017 proved to be a pivotal year, especially in the socio-political realm, which has forced many brands and businesses to re-look their approach.

Below is an executive summary of the shifts, innovations, and evolutions in the six TRENDS pillars.

1. Technology

Robot citizens

We're still getting used to the idea of 'co-bots' (robots that work alongside humans taking on menial or routine tasks). Last year, Dubai started deploying real robot cops to assist its police force. Saudi Arabia went one step further and granted full citizenship of the kingdom to Sophia – the first female humanoid robot, created by Hanson Robotics. In China, engineer Zheng Jiajia went beyond the contentious issue of sex-bots and built his own female robot, which he married in a traditional wedding ceremony. It seems that the era of transhumanism has officially begun.

2. Retail

Magazines blur retail boundaries

Magazines are re-contextualising the relevance of their content by becoming retailers. As highlighted in the Flux Trends New Rules of Retail report, fashion magazines are exploring hybrid solutions to tackle the decline in both retail and publishing. *Marie Claire* hosted a three-week pop-up, the next big thing concept in NYC last year. The store focused on three popular sections in the magazine and brought them to life in the retail space. This dovetails with the rise of 'Instagram Playgrounds', where retailers

are creating environments specifically designed to be captured for the Gram. The Museum of Ice Cream is currently one of the trailblazers exploring new opportunities in social media commerce.

3. Economy

Brands pivoting into finance

The traditional approach to banking is dwindling exponentially. Already 62% of millennials are happy to pay via a trusted brand's app, rather than traditional banking systems.

The creation of apps that enable consumers to open bank accounts and purchase government bonds without Financial Intelligence Centre Act (FICA) regulations are emerging. Brands are creating new avenues to interact with consumers. Many are doing so by providing alternative financial services. This year sees the opening of Discovery Bank and the creation of Uber credit cards. Starbucks has already announced its intention to pivot into a mobile payments company, while Snapchat and Apple have already filed for trademarks for peer-to-peer payment platforms. The death knell for banks is sounding loudly. ▶



4. Natural world

Bio malware

As researchers explore the prospect of storing data using DNA (yes, really), scientists have already created a security threat to this futuristic concept. Bio hackers from the University of Washington have found a way of encoding 'malicious software' onto DNA stands. The malware is not intended to harm its human host but instead becomes a means of corrupting gene sequencing software and take control of the underlying computer. A real concern as we embrace new forms of biometrics.

Tadayoshi Kohno, a computer science professor at the university, commented: "This means when you're looking at the security of computational biology systems, you're not only thinking about the network connectivity and the USB drive, but also the information stored in the DNA they're sequencing. It's about considering a different class of threat."

5. Diplomacy

The first Minster of AI

In pursuit of harnessing future skills and investing in the development of science and technology, the United Arab Emirates has become the first nation to appoint a Minster of Artificial Intelligence. Omar Bin Sultan, 27, will focus on rebranding the country as a Middle Eastern tech hub. Their plans are ambitious: not only do they see Dubai achieving a 25% robot police force by 2030; they have also joined the race to place autonomous vehicles on their roads and launch flying taxis in their skies, that's besides the parallel investments in various hyperloop projects and a plan to reach Mars.

6. Socio-cultural

Woke to wide awake

Issues of identity – specifically those of race, gender and culture – played a critical role in shaping pivotal social movements in 2017. Joined by the #MeToo viral campaign at the end of the year, these movements will ensure that brands, businesses and politicians tread carefully as they navigate a changed socio-cultural landscape of what is, and is not, acceptable. In 2018, additional (and more complex) undercurrents of gender fluidity and gender neutrality will come to the fore, as seen with the banning of gender stereotype advertising in the UK. As brands shift their focus to Generation Z, they will need to be hyper aware of Gen Z's broad yet defiant stance on identity. [🔗](#)





Decision-making through a behavioural economics lens

by Dr Francois Laurens

Member Board Member: The Banbury Trust;
Visiting Faculty: Gordon Institute of Business Science (GIBS)



Humans often act irrationally, which means they often make incorrect decisions when investing. What pitfalls should investors look out for?

Global markets are experiencing the longest run of tranquillity in history with record highs on the world's equity markets. However, the low market volatility and reduced levels of investor anxiety are enigmatic considering evident market anomalies, rising political risks and uncertainty related to, amongst others, a decline in economic prospects in some countries, high unemployment, stagnating real wages and growing inequality.

Considering the risks, it may be prudent for the investment industry to prepare for a return of volatility as the next significant materialisation of uncertainty may simply be a question of time. In a period of increased uncertainty, sound investment decisions are vital. However, irrationality often dominates investment decisions and policies. Gaining a deeper understanding of this phenomenon creates opportunities to not only improve own decision-making but also to exploit the irrational decisions of others.

Humans are predictably irrational

Neo-classical economic theory assumes that investors are rational *Homo economicus* (Econs). Decisions are assumed to be unbiased and based on 'rational expectations'. However, a growing body of research provides evidence that human reason is bounded by intuition, culture and faulty memory. Humans don't just reason poorly, but are systematically biased. Moreover, these mistakes can aggregate in the market.

The enigma of reason

In a perfectly rational world, Econs would assess the probability and the utility of all possible outcomes and weigh them to make decisions. But all the facts are not always available and all the outcomes are not known.

Efficiency of intuitive conclusions applies when the cost of occasional mistakes are acceptable. For this purpose, humans have developed heuristics – time-saving rules to simplify the decision-making process when assessing probabilities and predicting values to make decisions under uncertainty or complexity. These are based on subjective assessments which are processed according to heuristic rules (relying on knowns to draw conclusions about unknowns).

Although useful, the application of heuristics may result in errors when ignoring the need to assess the probability of an uncertain or complex outcome, value or quantity. Moreover, as reasoning is bounded and if intuitions are endorsed without challenge, these turn into beliefs and deliberate choices. The unmitigated reliance on heuristics and intuitions can therefore result in predictable cognitive biases (systematic errors).

Heuristics and cognitive biases

Heuristics are numerous and include the *anchor-and-adjust heuristic*, which applies when considering a specific value for an unknown quantity. A value is chosen with reference to an observable prior point of reference which is then adjusted mentally. Bias occurs when the lazy mind makes insufficient adjustment from, or is blind to, the *base rate* – a likely value or quantity determined through past observation). By using techniques such as priming (whereby exposure to one stimulus influences a response to a subsequent stimulus) and the decoy effect (where consumers' preferences are manipulated by presenting a decoy product that is inferior to the product the vendor wants to sell), it may be possible to exploit the biases of others. Anchoring biases manifest, for example, when a ►



negotiating party proposes an anchor value, when an auction process provides a suggested value or when investors fixate on the original purchase price.

The *availability heuristic* is another example which applies when estimating probability (frequency) according to the ease with which similar instances come to mind. Bias caused by prevalence of emotional and intensity exposure results in incorrect assessment of probabilities. Examples include overreaction to positive or negative market news; 'home bias'; finding patterns and trends in random data; and placing exaggerated focus on what happens in countries, industries or firms that seem to shape the evolution of things to come.

The *representative heuristic* occurs when basing judgment of probability on similar prototypes, for example, the halo effect, predicting future returns based on past performance and basing decisions on quantity samples that are not representative.

In addition to the above biases, *framing* (a technique to present the same information differently to evoke different emotions and reasoning) can be used to influence negotiations. Lastly, the *overconfidence and hubris* of others, which often cause people to be blind to risk and probability, may be exploited.

Mitigating biases

Awareness of the effects of heuristics and biases enables improved decision-making efficiency through conscious effort to set appropriate decision thresholds. It also allows one to focus on quantitative (objective) and qualitative (subjective) factors. Funding decisions often disproportionately weight the 'soft' considerations – assessment of these subjective considerations is highly

dependent on imperfect signals and psychological factors. This leads to inefficiencies and excludes many entrepreneurs and ideas from funding due to ignorance in decision-making. [🔗](#)





Fund raising: LP perspective

by **Nabeel Laher**

Head of International Private Equity:
Old Mutual Alternative Investments (OMAI)

How has the fund raising landscape changed the past few years from an LP perspective?

NL: Last year saw a recovery in terms of private equity funds raised after some leaner years triggered largely by downturns in the major African economies. This year fund raising promises to be better still, especially as the World Bank is forecasting GDP of 3.2% for sub-Saharan Africa in 2018. African private equity is also likely to benefit from the strong international economic recovery.

The recent leaner years have actually left a positive legacy for the private equity industry. Not only have limited partners (LPs) accumulated substantial sums to invest in good projects, we've also experienced wholesale improvements in the efficient operation of private equity, from better project selection and management, through to measurable improvements in terms of governance, the environment and social outcomes for communities.

Considering the GPs that have recently been successful in fund raising, what can their colleagues or peers learn from their approach?

NL: The general partners (GPs) that have been most successful at attracting LPs' funds have been better at differentiating and communicating their distinctive offers. They have successfully demonstrated that they

have existing strong networks on the ground, solid project availability and a rigorous approach to governance and project management.


Their peers can learn that successful GPs also provide better quality management information and data, including in areas once regarded as softer issues, such as environmental benefits and social outcomes. These are now absolutely fundamental to fund raising success.

How can GPs best position themselves to LPs when fund raising in the future?

NL: When fund raising in the future, GPs need to show they have strength and depth in particular industry sectors and have active networks of trusted partners, particularly ones that they worked with on recent deals.

GPs that can show the greatest experience and insight into local investment markets will also be more valued by LPs.

GPs should also position themselves as transparent on their own performance and on their fee structures.

Lastly, if GPs can show their business is not solely based on management fees and that they are willing to co-invest and share more of the control with LPs, they are positioning themselves effectively as equal partners, which is attractive to many LPs. 

Deal Tracker | Technology

PE Fund Kingson Capital
Target company Home Cloud Solutions
Industry ICT
Deal value R13.7 million
% shareholding taken 33.0%
Date 5 June 2017

Comment

Home Cloud is the fastest growing LTE data service provider in SA, with a niche focus. It currently on-sells both Telkom and Vodacom products, and has become the largest dealer in the Telkom stable. Our investment has enabled Home Cloud to move up the value chain. Not content to stay in the low-margin volume game of being a dealer, Home Cloud has started to own its own customer book, which is driving strong revenue growth. Innovation remains core, and other initiatives to move up the value chain or increase current margins are already being implemented or discussed with external service providers.

PE Fund Kingson Capital
Target company TrackBox Technologies
Industry ICT
Deal value R16.7 million
% shareholding taken 30.0%
Date 28 August 2017

Comment

TrackBox is a singular platform that connects South Africans to emergency services and allows emergency services quick access to important personal information. The innovation is in the back-end case management system and the authenticated tracking and tracing technology that makes this unique. The technology is so successful that both SAPS and the Hawks have partnered with TrackBox, along with Afriforum and several municipalities who are in the process of adopting the technology. Our investment has assisted TrackBox in funding the development and putting in place a broader go-to-market strategy to get this product into as many hands as possible.



The South African regulatory landscape in 2018

by Shelley Lotz

Head of Regulatory Affairs: SAVCA

This year, the industry will see a number of substantial proposed changes to the regulations which govern it. In the coming months, SAVCA will provide industry specific input and comment on the various draft regulations.

Following the financial crisis in 2008, regulation was largely criticised for failing to protect customers, prompting regulators throughout the world to undertake a review of financial regulation. In 2011 the South African government published a paper introducing the concept of a new regulatory framework for financial institutions. This regulatory framework (referred to as "Twin Peaks") took a step closer to being implemented when, on 21 August 2017, President Jacob Zuma signed into law the Financial Sector Regulation Act (FSR Act). The FSR Act allows the Minister of Finance to determine a commencement date by publishing in the Government Gazette – not yet in effect. The FSR Act is the first piece of legislation to be signed into law commencing the process to overhaul the current regulatory framework to the proposed model under Twin Peaks.


The background to this legislative change is to consolidate and harmonise a fragmented set of regulations into a single approach for all financial institutions. The proposed approach is that two newly constituted regulatory bodies will be responsible for regulating the entire financial sector including, among others, banks, insurers, private equity (PE) and venture capital (VC) fund managers. The powers and authority of the newly constituted regulatory bodies, the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA), are given their mandate and powers in the FSR Act. These regulators are expected to be set up during the first half of 2018, where the PA will be housed at the South African Reserve Bank and the Financial Services Board (FSB) will become the FSCA.

The PA's objective will be to promote and enhance the safety and soundness of regulated financial institutions; while the FSCA will be tasked with protecting financial customers through supervising market conduct.

There are various other pieces of legislation which will set out the roles and responsibilities of financial institutions, the first of which is expected to be the Conduct of Financial Institutions Bill (COFI). The COFI Bill, which is expected to deal with conduct and licensing of financial institutions, is likely to be issued for various rounds of public consultation in 2018.

The following points are relevant for PE and VC practitioners in terms of the Twin Peaks legislation:

- National Treasury amended the Financial Advisory and Intermediary Services Act (FAIS) to include the definition of an Alternative Investment Fund and expanded the definition of financial product to include an investment into such a fund. SAVCA's understanding is that PE and VC funds will fall into this definition, providing a first step for the regulator to provide specific industry regulation.
- During 2018, SAVCA is expecting a host of draft regulation for industry to provide comment and input as well as amendments to existing financial sector regulation.
- The wholesale shift in regulation is likely to have an impact on PE and VC firms both in terms of how they treat customers as well as how they deal with regulators.
- The paradigm shift in regulation to an outcomes-based approach will require a substantial adjustment for both regulators and industry.

SAVCA will continue to engage with regulators in a positive manner together with commenting on proposed regulation from a PE and VC perspective, together with providing members with bi-annual updates on the proposed regulatory changes. 

Deal Tracker | Health Care

PE Fund
Target company
Industry
Deal value
% shareholding taken
Date

Abraaj Africa Fund III
Joint Medical Holdings
Health Care
Undisclosed
51%
December 2017

Comment

Abraaj is supporting the expansion of the business nationally and beyond South Africa to provide economic health care solutions along with key founding doctor shareholders. The focus will be efficiencies, productivity and improved health care service.



Transactors Talk

by **Samantha Pokroy**

Founder and CEO: Sanari Capital

Tell us about Sanari Capital; where do you play in the market and what is your differentiation?

SP: Sanari Capital specialises in investing in founder-run, owner-managed or family-owned businesses in the lower mid-market.

As a founder-run, owner-managed business ourselves, we have a deep understanding of the particular needs, challenges and aspirations of this market. Our prior investment experience in this niche means we're able to recognise and address the obstacles that often stand in the way of growth, and create a disconnect between owner-management and their private equity investors.

Our understanding, coupled with our experience of institutional investment best practice, enables us to unlock the significant value that exists in these businesses, filling a gap in the traditional private equity market.

We differ in other ways too. To drive investment returns for investor and investee alike, we have developed our forward-thinking 3S Solution which focuses on Sustainability, Scalability and Saleability.

We've always appreciated the benefits of having an investment team with a long track record and a host of successful realised investments. Our diverse backgrounds and perspectives bring a new and necessary quality to the PE market which supports transformation and diversity, but there is one thing we all have in common: the goal of Profit with a Purpose.

The capital we invest confers 100% black ownership and significant black women ownership and management to our underlying investments, helping companies achieve their transformation objectives and resulting in significant competitive advantage.

What have Sanari Capital's deal activity highlights been in the past year?

SP: In the past 12 months we have made one new investment into Fernridge Solutions, a follow-on investment into JAYCOR International, and we're currently working on another two investments.

Our Fernridge investment fits with our targeted investment theme: 'Data is the new gold'. This company is a leading geo-spatial data and solutions provider. We intend leveraging and expanding their proprietary datasets to provide clients with ever richer business insights.

In just six months, we have effectively deployed key components of our 3S Solution, including strategy formulation and organisational architecture to deliver a new CEO and introduce world-class business development capabilities and data expertise.

JAYCOR fits in with our 'Connected World / Industry 4.0' investment theme, distributing components critical to the connectivity and automation needs of a variety of industries.

What are some of the major challenges that Sanari Capital has faced in its four years of existence and how were they overcome?

SP: Our investment focus was clear from day one; how we would raise capital as a new entrant was less clear. We chose to fund our investments on a deal-by-deal basis while we built our track record, which we have done, but the lack of committed capital has at times slowed our progress.

Consequently, we are beginning capital raising for our Lower-Mid Market fund, targeting investments with enterprise values up to R500 million in South Africa, and incrementally into other select sub-Saharan African markets. In the interim, we continue to fund investments deal-by-deal and through our limited raise Section 12J investment vehicle.

The other big challenge, as any new fund manager will testify, is resourcing your strategy prior to having committed capital! We've been fortunate to have the support of many members of the industry and have become loyal fans of our legal and tax advisors, particularly Joshua Janks and Mark Linington, for their critical support and advice.

What can we expect from Sanari Capital in the next 12 months?

SP: Our priorities are to conclude the investments we're working on; support our portfolio companies in the deployment of the 3S Solution and in targeted acquisitions; and raise capital. 2018 is off to a very promising and busy start. We're encouraged by recent developments setting our country on a more sustainable and prosperous path. We'll continue to play our part by supporting inclusive growth in South Africa through our investment programme and industry involvement. We're looking forward to strong tailwinds in the real economy for all our portfolio companies! 



The future of private equity: Enabling regulatory change

by John Bellew

Partner and Head of Private Equity: Bowmans



While the local regulatory environment is becoming more accommodating towards the private equity industry, there remains a need for a specialised permanent capital vehicle that can also be listed, which would appeal to investors with differing time horizons. How can this be addressed?

The story of private equity in South Africa has been one of stellar success in growth, job creation and black economic empowerment, and in the delivery to limited partners of market-beating returns. It is a good news story of the power of patient capital and of the benefit to businesses of sound commercial and strategic advice. It is also the source of a lot of "unseen" foreign direct investment from non-residents investing in local funds.

This story has however unfolded against a backdrop of initial regulatory suspicion and in an uncertain regulatory environment. I recall well an early lobbying engagement with a regulator (which shall remain unnamed) whose representative received me with an initial statement along the lines of "Private equity? I know it well. You are the guys who strip the assets, fire the employees and destroy the tax base." In fairness, some pre-financial crisis deals did stretch the leverage levels somewhat, but generally the industry has more resembled wise men bearing gifts than barbarians at the gates. And over time our regulators have demonstrated a growing understanding of the industry and how it operates.


So how can we fundamentally improve the regulatory environment for this asset class? Much work has already been done and much more is ongoing, but to my mind the biggest issue for the industry is the need to create a fit-for-purpose local vehicle that will truly open up private equity to a much broader range of investors.

As the private equity industry evolves, participants are questioning the traditional model with its limited life funds and are increasingly looking to more permanent capital vehicles that can be listed. The problem is that there is no South African entity which is tax transparent (essential for

traditional investors in private equity that are themselves tax exempt), which can be freely marketed to the public (broadening the investor base) and which can be listed on an exchange to accommodate investors with differing investment horizons. Mauritian companies are being used with a degree of success, but they come with their own tax challenges and it would be good to have a proudly South African solution too. We have even contemplated forcing the square peg of private equity into the round hole of hedge fund collective investment schemes, which has left everyone from regulators to the JSE to fund managers frustrated and unhappy, and we have still come up short.

One solution may be to enable a collective investment scheme that could invest in unlisted securities, but in my experience the Financial Services Board seems wary of this approach, and it is probably not a viable solution in the short term.

An elegant solution may lie close at hand, though. In some markets, companies can elect to "tick the box" and be treated as either taxable or tax-transparent entities. This is enormously attractive. There is obviously detail to be thought through to avoid abuse, but the benefits are obvious. A company offers protection to investors via the public provisions of the Companies Act, so investor protection is already addressed. A company can accommodate a broad range of investors, making private equity accessible to new investors. Companies offer the purest form of limited liability to their investors and are easily listed, catering for investors with differing time horizons. Adding tax transparency would mean that the tax profiles of individual investors could all be accommodated in one entity.

What is there to lose? 

PE Fund AIIF3
Target company DSM Corridor Group (DCG)
Industry Ports & Logistics
Deal value Undisclosed
% shareholding 60%
Date February 2017
Jurisdiction Tanzania

Comment | About the asset:

DCG is the dedicated bulk terminal in the port of Dar Es Salaam handling commodity exports and fertilizer imports. DCG serves as the cornerstone investment in AIIM's development of a pan-African ports platform in partnership with a team which has a demonstrated track record of operational excellence. The terminal has a capacity of 25,000m³ to handle all free flowing, non-liquid bulk commodities. The strategic positioning of Dar Es Salaam offers highly competitive unit economics along key regional transport corridors.

Investment thesis:

- Significant opportunity to enhance cost effectiveness of logistics corridors in sub-Saharan Africa which continue to lag global peers on logistics performance.
- Consolidation opportunities arise from higher focus of strategic players on large container terminals as opposed to smaller dry-bulk and multi-purpose cargo terminals.
- Strong dry bulk volume growth potential driven by latent demand for key inbound volumes together with recovery in commodity markets for outbound mineral exports.

PE Fund AIIF3
Target company Amandi Energy Development Ltd
Industry Thermal Power: Combined Cycle Gas Turbine
Deal value Undisclosed
% shareholding 13.6%
Date December 2017
Jurisdiction Ghana

Comment | About the asset:

Located near Aboadze in the Western Region of Ghana, Amandi is a greenfield multi-fuel combined cycle turbine power plant of about 200MW capacity. The project achieved financial closure in December 2016 and is currently under construction. Upon commencement of operations, the project will sell power to the Electricity Company of Ghana under a long term Power Purchase Agreement (PPA).

Investment Thesis:

- Opportunity to invest in a competitive power generation project selling electricity to the national utility in Ghana.
- Various power sector reforms are underway in the country to improve the long term sustainability of the sector including the re-profiling of PPAs to address potential generation overcapacity, the issuing of an energy bond to pay off the energy sector debt, sector and the privatisation of state utility, Electricity Company of Ghana.
- The aforementioned reforms and cost reflective (but affordable) retail tariffs help to position Ghana as one of the most attractive investment destinations for power in the African market.

PE Fund Namibia Mid-Cap Fund
Target company Swanib Cables (Pty) Ltd.
Industry Light Infrastructure
Deal value N/A
% shareholding taken 100%
Date 28 August 2017

Comment

The Transaction is expected to provide financial and development benefits, including:

- 1) localising the shareholding (including previously disadvantaged Namibians and staff;
- 2) incentivising empowerment partners to grow the value of the business; and
- 3) job creation.

PE Fund AIIF3
Target company Albatros Energy Mali
Industry Thermal Power: Heavy Fuel Oil
Deal value Undisclosed
% shareholding 44%
Date June 2017
Jurisdiction Mali

Comment | About the asset:

Albatros Energy Mali will be Mali's first independent power project (IPP) to feed into the national grid. The power plant is a 90 megawatt (MW) thermal power station in Kayes, western Mali and is being delivered under a build, own, operate and transfer (BOOT) concession. It will provide a much needed sustainable energy source adding roughly 15% capacity to the grid for Mali's citizens and enabling industry to grow. Construction of the project has commenced in July 2017 and is expected to take 16 months to complete.

Investment thesis:

- Current installed electricity generating capacity of Mali stands at 352MW. Demand for power is growing at c.10% p.a. driven by an expanding population/domestic consumers, industry and mining. Lack of reliable lower-cost grid electricity is a barrier to growth, specifically for industry and the mining sector.
- The country utilises a mix of domestic and imported electricity, produced by hydropower plants and diesel generators, with current pricing at a premium to new generation.
- The provision of a 90W HFO plant provides reliability of supply, at a lower tariff than the temporary diesel power generators can provide.

PE Fund Vantage Mezzanine Fund III
Target company Purple Capital
Industry Shopping Centre
Deal value \$12.5 million
% shareholding taken N/A
Date November 2017

Comment

Purple Capital is the developer of the iconic 6,000m² Maryland Mall, a fully tenanted neighbourhood shopping centre in the Ikeja district of Lagos, Nigeria. Maryland Mall is one of the few formal shopping malls in Lagos, and attracts over 30,000 weekly visitors.

PE Fund AIIF3
Target company Starsight Power Utilities Limited
Industry Distributed Power: Energy efficiency solutions
Deal value Undisclosed
% shareholding 21.8%
Date November 2017
Jurisdiction Nigeria

Comment | About the asset:

Starsight is an energy company offering solar-diesel-battery hybrid solutions and captive power to commercial and industrial customers. The company has completed a successful pilot exercise in Nigeria with plans to roll out further across West Africa. The business has a confirmed order book for more than 500 sites and expects to rollout to over 1,200 sites over the medium term, to a diverse customer base across a range of different sectors.

Investment thesis:

- Nigeria's 16GW power demand deficit, coupled with insufficient generation, inefficient transmission and distribution, as well as latent constraints in gas supply and transmission capacity will hinder widespread availability of grid power in the medium term.
- Nigeria accounts for 75% of the total diesel fuel demand in sub-Saharan Africa, at a cost of c. \$2 billion per annum with small scale diesel power generation costing 4-5 times the amount of grid-supplied power.
- Existing market opportunity to reduce the diesel generation burden via implementing efficiency measures and introducing more cost-effective solar PV and storage equipment.

SAVCA Membership

SAVCA pro-actively lobbies on behalf of the industry and its members. The association offers its members access to training and education, industry networking events & industry research.

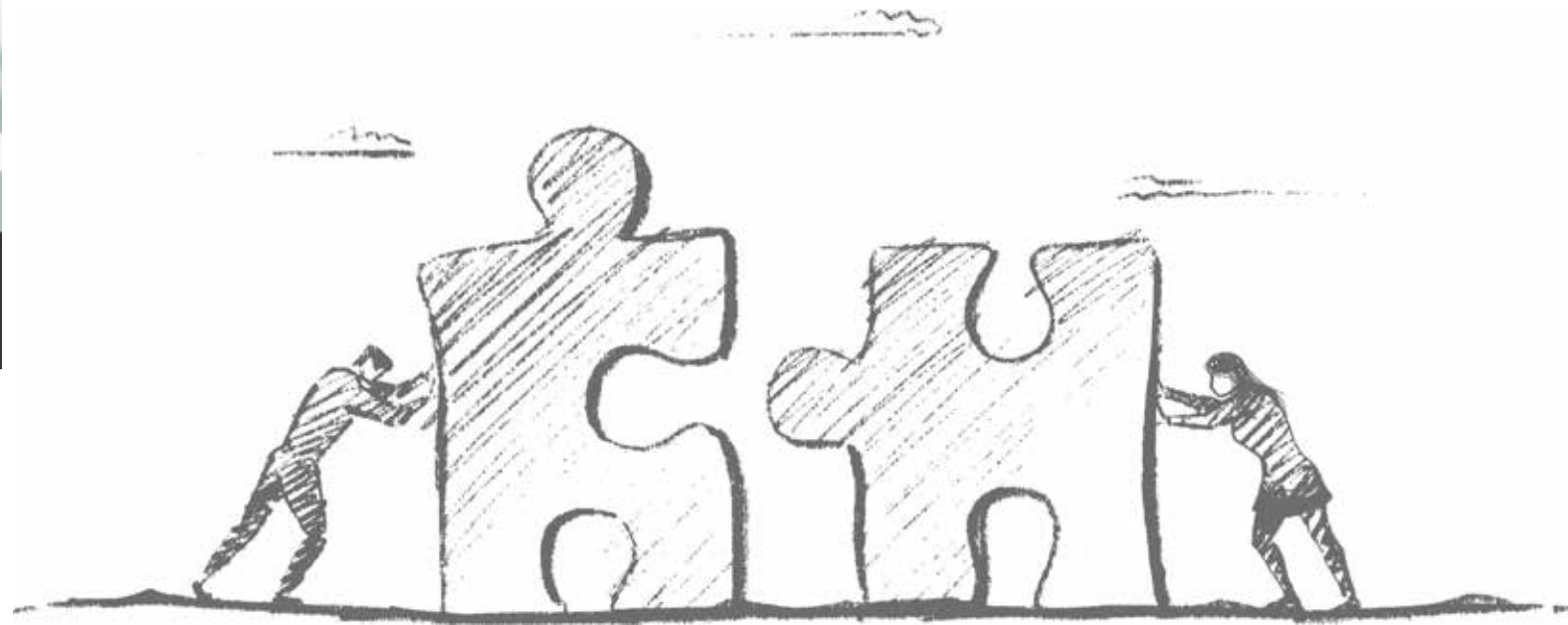
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**The SAVCA team would like to thank everyone
who made a contribution towards this publication!**

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.

SECURED

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