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Catalyst

From the Editor's desk

Private Equity is intrinsically neither good nor bad

Private Equity is intrinsically neither good nor bad … it is appropriate for some companies and not for others, says Bain Capital's Dwight Poler. Furthermore, the days of the asset strippers are over – it's all about growth.

This may well be debatable, but there is no doubt that private equity is not in itself either a good or a bad thing for a company. It is the way in which it is managed that determines whether it adds or destroys value.

In considering private equity, whether as a prospective investor, a government legislator or an employee of a 'target' firm, any analysis must be based on reality, not on hype or emotion - on both sides.

Therefore, in considering private equity, whether as a prospective investor, a government legislator or an employee of a 'target' firm, any analysis must be based on reality, not on hype or emotion – on both sides.

This is particularly important in South Africa today, where recent events have thrust the asset class to the fore, increasing scrutiny of the industry. The higher profile has seen discussion – and changes – regarding the tax implications of private equity, criticism of public to private buyouts and concerns raised about the entry of foreign players into our market.

While it may be that important principles need to be debated in order to ensure level playing fields and fair play, it is important that sanity and caution should prevail in order not to inhibit the potential for economic development that private equity can generate. And any concerns notwithstanding, the buyout of Edcon should be seen as an extraordinary vote of confidence in South Africa and the benefit of this should not be lost.

Just as *Catalyst* was heading to the printers, came news that the Brait-led acquisition of Shoprite was off. Which just goes to show that markets and minorities can in fact prevail. It now remains to be seen whether the immediate surge in the Shoprite share price following the announcement is followed through - if those who complained about price will push the counter closer towards what they said they believed would be a fairer offer.

Luc Albinski, a director of Johannesburg-based mezzanine fund Vantage Risk Capital, knows who he 'blames' for the rash of massive private equity buyouts: "Nanny-style" boards are creating favourable conditions for this by directing companies in an excessively risk-averse fashion, he says. Listed companies that should be taking advantage of highly competitive debt markets to gear up, expand their businesses and return to capital to shareholders, are sitting with substantial cash balances in a "nanny-induced comfort zone." And businesses run this way make tempting targets for private equity firms which leverage their investments aggressively, focus on maximising cash flows and paying down debt quickly. Anybody listening?

At a time when private equity in South African is at an all-time high, the industry appears unwilling to support a publication dedicated to the sector. This is with a few exceptions, who we thank for their contribution and confidence. *Catalyst* has thus far been produced at a loss and the company is reluctant to continue publishing it on this basis. Consideration is being given either to closing it entirely or to resuming its publication as part of the quarterly issues of *DealMakers*, the corporate finance magazine.

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Jane Strachan

By the time the Blackstone Group's final offer for the US property company EOP was on the table, it included a twice-increased break-up (or break) fee of $720m.

Those controversial break fees

At about the same time, there was commentary in the South African media about break fees as deal protection mechanisms, with particular reference to the R30m fee included in the transaction proposal regarding the Actis-led consortium working to take over Alexander Forbes and the 1% of purchase price break fee in the Bain Capital buyout of Edcon.

A "break fee" is a fee that is usually payable by the target company (whose directors have agreed to support a negotiated acquisition transaction by the bidder) to a bidder in a buyout if the deal falls through as a result of certain clearly-defined events, usually outside the control of the bidder; most often, if the target company board accepts a third-party bidder's (higher) offer.

The fee enters the picture only once the board of the 'target' company has formally agreed to proceed with a bid from a particular prospective buyer.

The break fee is justified by those who seek them on the basis that it is compensation for the time and costs incurred and the resources expended by the bidder in pursuing and negotiating a transaction with the target. In addition to actual costs for lawyers, accountants and other advisors, there is also the opportunity cost, usually unquantifiable, in pursuing a large transaction. A board's rationale for agreeing to a break fee is that a higher offer would more than cover the fee – in other words, the break fee will kick in only in the event of a materially higher offer being accepted, and this is of benefit to the shareholders. It is, therefore, effectively "self-funding", proponents argue.

In some transactions, the break fee is in fact mutual, and the bidder will agree to pay a break fee under certain circumstances, as was the case in the Edcon deal, for example.

The argument against break fees is that the bidding company is merely "doing its job" in making a bid (in the case of third party private equity companies, "bidding with other people's money") and that the prospect of failure is an aspect of business which many companies face … with no prospect of compensation.

The primary concern is the potential for break fees to dissuade competing offers from third parties and to put pressure on target shareholders to accept a bid without the opportunity to consider any competing offers.

Actis investment principal Garth Jarvis agrees the break fees have always been a particularly acrimonious aspect of the M&A arena, but responds: "The costs of putting together a large bid are enormous. The legal and accounting fees are among the direct costs, but then there is also the opportunity cost – our time and the cost of tying up our capital. Once an offer is made, the business is put into play which ensures a value creation opportunity for shareholders. However, in doing so there is a high risk that another higher bidder may emerge. The break fee is to ensure that any counter bid is at a substantially higher price, thereby ensuring shareholders get an even better deal."

He stresses that a break fee will not kick in without their having been considerable additional wealth creation for the average minority shareholder, expressed through the higher price achieved.

Jarvis notes that, in the case of the Alexander Forbes transaction, the agreed break fee would not even cover the quantifiable legal and due diligence costs already incurred, to say nothing of the opportunity cost represented by the extensive internal resources devoted to the transaction over the course of over a year.

The Securities Regulation Panel (SRP) closely looks at break fees to ensure that there is no abuse of minority shareholders rights. The concept first required the Panel's attention during the (failed) merger between Goldfields and Franco Nevada Mining in 2000, where the agreement provided for a US$70m break fee.

Garth Jarvis

"When the concept of a break fee was mooted, there was tremendous pressure on us as the regulator to accept it," says SRP Deputy Executive Director Vivian Pitchers. "We were told it was common practice worldwide and that if it was not allowed in South Africa it would be an impediment to normal takeover activity in this country."

So the SRP was persuaded that in order to facilitate economic growth, in particular foreign direct investment, it should allow the break fee.

"We reluctantly agreed but we still don't like the concept," Pitchers tells Catalyst. "However, we would not agree to a break fee of more than a maximum 1% of the transaction cost."

His colleague, SRP Compliance Officer Lucky Phakeng, concedes that, legally, the concept of agreed "liquidated damages" is acknowledged.

"A break fee seeks to quantify upfront the cost of a deal falling through, avoiding the need for the bidder to provide proof of the costs incurred should it decide to sue the target for damages on breach of contract," Phakeng says.

Nevertheless, the concept does not sit well with Pitchers and Phakeng, who say break fees may prevent competing offers, see benefits flowing only to certain parties and potentially add costs. "There is no doubt that break fees have the potential to make a bid more expensive, particularly when the offer is fully-priced. In a fully-priced bid a break fee can be an artificial impediment to a competing bid."

And why should a prospective buyer receive protection from the bidder for the cost of doing business? they ask.

The SRP is, however, not averse to the concept of a reverse breakup fee: "We have no problem if a private equity company agrees to pay a fee in the event of its decision to walk away under certain circumstances."

In the US, the size of the break-up fee is typically 2.0% to 3.5% of equity value, but can even be as high as 5%.

The higher fee is being attributed to today's more onerous regulatory environment. Says Guhan Subramanian, a professor at Harvard Law School: "Sarbanes-Oxley requires more due diligence, which requires effort and time that you want to get compensated for if the deal is not completed."

In the UK, the Listing Rules of the UK Listing Authority requires approval to be sought for a break fee of more than 1% of the equity value of the listed company. Regardless of the quantum, the UK Takeovers Panel requires a target company to consult with it at the earliest opportunity if a break fee is proposed and for the target and its financial adviser to confirm to it in writing that, among other things, they believe the fee to be in the best interests of the target company's shareholders

Australian Takeovers Panel applies a 1% of equity value guideline for break fees but is seemingly prepared to consider a higher fee under certain circumstances. Similarly, there is no requirement in the Australian Stock Exchange Listing Rules for shareholder approval to be sought for a break fee in excess of 1% of the equity value of the listed company (as is the case in the UK under the Listing Rules of the UK Listing Authority)

In terms of the coercive element of break fees, the Australian Panel considers that triggers can have a coercive effect on sellers/shareholders because they affect the circumstances in which the break fee is payable. However, in the Australian Panel's view, when payment of the fee is triggered because of a more attractive counter-bid, there is unlikely to be any coercive effect on sellers/shareholders, as the success of the competing proposal has commercially supplanted the proposal that had been supported by the break fee agreement.

Canadian break fees tend to be in the 3% range. The Canadian Coalition for Good Governance, in its commentary on break fees, describes their origin as:

> **"There is no doubt that break fees have the potential to make a bid more expensive, particularly when the offer is fully-priced. In a fully-priced bid a break fee can be an artificial impediment to a competing bid." - SRP.**

"Once a company is "in play", the directors of the target company have an overriding duty to seek the highest value for the securities of the target company. Generally, this duty is performed by actively canvassing the market for competing bids or "alternative transactions" that maximize shareholder value. Typically, but depending upon the circumstances, the board creates a special committee of independent directors, retains investment advisors to seek bidders or propose alternative transactions, engages legal counsel to advise the independent committee, and undertakes a formal auction process for the company.

"A common problem encountered by a board trying to attract an acceptable or competing bid is the high cost (both in terms of time and money) and "deal uncertainty" faced by a potential suitor entering into the process and "stepping up" to make an acceptable or superior firm offer. In attempting to induce an acceptable or superior bid, the board is usually met with a bidder requesting what is commonly referred to as "deal protection" – mechanisms to ensure that its deal has an acceptable probability of being completed, with downside protection for the bidder if another trumping bid emerges that it is not prepared to match."

The Canadian body is, however, concerned about the size of break fees and the potential for these fees to deter competing bids. In addition, members are not satisfied with the level of disclosure of break fees, in particular the terms and rationale for entering into such an agreement.

Last year, KPMG International, in a paper on break fees, noted that break-up fees were "hardly new" to the world of mergers and acquisitions and had long been a key protection mechanism in major transactions.

It predicted that, in the US at least, the size of break-up fees would continue to rise until they reached a point where the market fought back – when alternative bidders could no longer be competitive in the deals.

"Some particularly large deals have made sellers express an interest in having some type of insurance in case buyers have trouble financing their transactions. For example, when a group of private equity investors joined forces for the $11,4bn acquisition of SunGuard in September 2005, the target company insisted on inclusion of a break-up fee if the deal failed to close because the private equity group couldn't raise the necessary funding, or if it breached the acquisition agreement in any other way. In that deal, the private equity group, which included Silver Lake Partners, The Blackstone Group, Bain Capital, Kohlberg Kravis Roberts & Co. LP, Texas Pacific Group Inc, Goldman Sachs Capital Partners, and Providence Equity Partners, agreed to a $300m reverse termination fee." ◆

So South Africa's largest private equity deal to date is done and Bain Capital, one of the largest private equity investors in the world, now owns Edcon. Remarkably, the transaction took not much longer to conclude than six months from start to finish.

Introducing patient (Bain) capital to Edcon

One of the main reasons for this, says Dwight Poler, the London-based MD who worked on the transaction for Bain Capital, is that the R25bn buyout, contrary to those deals that seem to take an age, was initiated by Edcon's board. In other words, the would-be buyers did not first have to convince a board to sell: the board took the group to the market, running a global auction process. Edcon CEO Steve Ross had realised that taking the operation private would enable growth without the demand of short-term reporting pressures.

"Edcon ran a very efficient process," Poler says, "with an effective global road show and every effort made to ensure the process went smoothly."

Bain Capital already had South Africa on its radar as a result of the Boart Longyear buyout in 2005, though, as Poler says, the Boart business was really more about a global opportunity than a purely South African play.

When the Edcon transaction first came across the Bain Capital team's desk early last fall, it was blind – there was no company name attached. "But the details of the company as outlined in the bid documentation made it clear it was a business with the kind of potential we like."

"We are big believers in investing in market leaders, and Edcon has almost 40% of the department store market, making it a very good company in the retail sector where we have strong experience. Furthermore, it was clear that the growth potential in South Africa was significant, with tremendous opportunity being presented by the emergence of the growing middle class."

Others said to have been part of the auction process were private equity giants Kohlberg Kravis Roberts and Blackstone.

Another factor that sped up the transaction was the pricing: Bain Capital's offer price of R46/share represented a 51,3% premium over the closing share price of R30,40 on October 16, 2006, the day before Edcon issued a cautionary announcement regarding "discussions with private equity parties."

Bain Capital put its best offer on the table. "It's a great company that we really wanted to own so we offered a significant premium to the trading price. It was a multi-stage auction, and we had to win out over other bidders."

And given that these negotiations came in the midst of the controversial Shoprite deal, it was likely that a premium of that quantum would keep potential quibblers at bay. It did, to a large extent, until Templeton Asset Management's Mark Mobius lodged a last-minute complaint with the South African Securities Regulation Panel, saying the bid was "at least 50% too low." Mobius said that while Edcon was trading on a one-year forward price-to-earnings ratio of 13,2, the ratio for similar companies in other emerging markets was 19,1 and, therefore, the offer undervalued the group. Templeton held a 3% stake in the retailer. The SRP dismissed the complaint.

Looking ahead, Poler says Bain Capital's goal is to provide support to the Edcon management team in executing its plan, not to run the business. "We have the strategic and financial resources to carry out the agreed strategy. A lot of our competitors in private equity come from investment banking and accounting backgrounds, and are more transactionally-focused, good at debt and multiple arbitrage strategies and so on. We come out of strategic consulting, which means we are able to bring ideas from a diverse range of businesses and industries where we have played a direct role in enhancing value. This is what differentiates us and gets us a lot of attention."

Bain Capital has an extensive track record of retail and consumer experience, having been an active investor in such market-leading companies as Staples, Toys "R" Us, Burger King, Dunkin' Brands and Domino's Pizza.

Poler is quick to stress that Bain Capital views Edcon as a growth investment and not a cost-cutting opportunity, and there are no plans to spin off any divisions. Edcon has a great market position already, he says, and by investing in new stores and formats, and building on opportunities for new products and services, growth will be achieved. For example, the financial services business suggests good potential: "The public equity market wasn't particularly happy with Edcon's consumer debt book, but we believe the company can manage – and grow – it responsibly and productively."

Bain Capital is adamant that, notwithstanding the high levels of debt in the transaction – understood to be about R17,5bn of debt, plus revolving facilities to support the company's seasonal needs and its consumer receivables – the business will not be put under financial stress from overly-onerous debt repayment schedules. This is because of Bain's philosophy of 'patient capital.' In line with this approach, the debt is entirely non-amortising, so the company pays only interest, with the principal being settled by a bullet repayment at a later stage, when Edcon is either relisted or sold to a trade buyer.

Funding will be through a combination of equity funding provided by Bain Capital and debt funding provided by a consortium of banks, led by Barclays Capital, ABSA Capital, Credit Suisse, Deutsche Bank and ABN Amro, with a broad group of South African and international lenders joining the syndicate.

Structuring of the transaction funding was discussed at length with the SA Reserve Bank, which was described as having been "helpful and supportive." The timing of the funding inflow also formed part of dealings with the SARB. The funds have been coming in "over time," which means there has not been, nor will there be, a single moment of impact from the inflow. (The shareholder vote in favour of the buyout firmed the rand up to 1,1% against the dollar, according to Reuters).

On April 16 this year, 80,63% of shareholders, comfortably higher than the requisite 75% approval, voted in favour of the Bain Capital proposal to acquire the entire ordinary share capital of Edcon at R46 per share.

The question, now that it has made such a major commitment to South Africa, is whether Bain Capital will contemplate other prospects here. The answer is that it will definitely be open to other opportunities, particularly in businesses that will be driven by emerging middle class growth.

"We continue to be interested in South Africa, with a focus on market-leading enterprises and in sectors where potential could be better realised by taking a company off the public markets and effecting change over the long term, influencing growth in a way that public investors cannot."

The firm considers itself most effective in companies with a total enterprise value of at least R5bn. "We are not looking to take deals away from local investors, but would be open to working with them if there was value in combining expertise – we would bring global experience and opportunities to the table, they might offer local market experience."

Worldwide this is an interesting time for private equity, and South Africa is no exception. Says Poler: "We know that private equity, for someone who is not familiar with the concept, can be threatening. Yet we believe it is not in itself good or bad – it is appropriate for some companies and situations, not for others."

For South Africa, private equity is potentially a great source of foreign capital and the extraordinary vote of confidence represented by the Edcon buyout should not be undermined, Poler concludes. ◆

The advisory teams:

Financial advisor to Edcon:	Caliburn Partnership
Legal advisor to Edcon:	Werksmans
Transactional sponsor and equity capital markets adviser to Edcon:	Merrill Lynch South Africa
Namibian sponsor:	Irwin Jacobs Greene
Private equity sponsor and transaction arranger for Newco:	Bain Capital LLC
Financial advisor to Newco:	Citigroup Global Markets Credit Suisse Standard Bank
South African legal advisor to Newco:	Webber Wentzel Bowens
International legal advisors to Newco:	Kirkland & Ellis International LLP
Independent advisor to the Edcon Board:	PricewaterhouseCoopers Corporate Finance

The recent announcement regarding the taxation of gains on long-term equity investments has clarified an important area of interest for the South African private equity industry.

Greater clarity on the interface between tax and private equity

In his February 2007 Budget speech, Finance Minister Trevor Manuel announced that all shares (both listed and unlisted) disposed of after three years (as opposed to the current five years) will trigger a capital gains tax (CGT) event, by definition lower than tax on revenue.

Currently, s9B of the Income Tax Act deals only with listed shares and excludes unlisted shares. If taxpayers choose to avail themselves of s9B (the 'safe haven' provision) then listed shares sold after five years will automatically be treated as capital. The difficulty that private equity has is that as s9B excludes unlisted shares there is no safe haven period for unlisted shares or any other legislation providing absolute certainty on when a gain on the sale of an unlisted share is capital or when it is revenue.

This is an issue on which the Southern African Venture Capital and Private Equity Association (SAVCA) and various industry players have expended considerable energy, through engagement with National Treasury and the SA Revenue Services (SARS).

Kevin Cron, director at attorneys Deneys Reitz, says there has always been a need to analyse whether assets are held for revenue or capital and, absent clear guidelines, decisions have been made on a case-by-case basis, with a greater chance of an investment being regarded as a capital matter the longer it has been held.

Kevin Cron

"With a private equity investment, the fund managers are clear upfront that they do not intend to hold the investment forever. However, the question was always whether the time for which it was ultimately held was sufficient for it to be treated as a capital asset, and this uncertainty has created difficulties."

He notes that the industry is naturally in favour of the capital approach (given the lower tax rate this attracts), arguing that PE entities are neither share traders nor opportunistic holders who sell at any arbitrary time purely on the basis of an increase in the investment's value. "They argue that their intention is to hold onto and improve the business, restructuring it if necessary, derive income and, ultimately, dispose of it. Revenue would always have to weigh the company's stated intention against what had actually transpired in order to arrive at a conclusion regarding tax status."

However, industry sources say inconsistencies tended to arise in this case-by-case evaluation, with unit trusts in particular receiving favourable treatment.

There remain other areas of uncertainty for Revenue and/or the South African Reserve Bank. For example, issues relating to the tax impact of recently announced very large public to private transactions, involving large offshore investors and debt providers, appear to be causing some concern and Catalyst understands that more than one private equity team has spent much time in Pretoria working through proposed deals and explaining the rationale for their structures.

Other areas of complexity, as noted by Michael Rudnicki, Director of Corporate Tax, at KPMG and the tax representative within the KPMG Private Equity Group, include:

- concerns regarding the abuse of group relief provisions for the deferment of tax;
- the deductibility of funding costs in relation to the acquisition of shares in a buyout, with particular concerns where the funding is coming from offshore;
- the legislation pertaining to trusts and partnerships, which impacts on private equity fund management companies;
- application of s8C of the Income Tax Act regarding the treatment of management's stake in a buyout – are they investing as investors or employees?

Nedcor Securities analyst Syd Vianello says it is also possible that a tax-related issue could arise for private equity in the form of "a non-resident tax on interest payable" on foreign loans made to non-government organisations. This would include private equity funds, which obtain by far the majority of their funding from foreign sources.

He believes it unlikely that Manuel would be happy to see billions of rand flow out of the country to repay interest on private equity loans. "Government may well decide to impose a non-resident tax on this interest, which would mean private equity investors would see their returns dramatically reduced," he says, though he adds that this is pure speculation on his part.

Rudnicki believes there is a tendency in some quarters to see private equity as a complex 'new' creature, whereas in fact "it is really quite simple – PE entities are just funds that acquire companies. This view of private equity as something unique and complicated seems to exist at SARS and elsewhere … whereas in fact they should simply be analysing each transaction on its own merits.

"The industry is not looking for favouritism, not suggesting that private equity is somehow 'special'" says Rudnicki. "However, nor should it be prejudiced when it seeks to use the current tax regime most effectively.

"Clearly there is an education process required – the fund managers need to be motivating their case, pointing out that, from a tax collection perspective, Revenue is no worse off as a result of the private equity deals we are currently seeing in the market.

"In addition, we mustn't lose sight of the fact that private equity investment (debt or equity) by international investors translates into foreign direct investment and an inflow of funds into South Africa, which trigger immediate taxable events in the hands of the existing shareholders."

There is a tendency in some quarters to see private equity as a complex 'new' creature, whereas "it is really quite simple – private equity entities are just funds that acquire companies". – KPMG

Deneys Reitz's Cron adds that the introduction of the Advance Tax Ruling System in October last year would also be a help in dealing with areas of uncertainty: the system is intended to promote clarity, consistency and certainty in the interpretation and application of the tax laws, thereby ensuring compliance.

Under this system, taxpayers may formally request a ruling from the Commissioner in connection with the interpretation and application of the tax laws to a specific proposed transaction, subject to certain limitations.

Provided that there is full disclosure

of all material facts, the ruling will generally be binding on the Revenue when an assessment is made in connection with that transaction.

"I understand the system is working quite well and that rulings are not taking too long," Cron adds.

He comments that, until the last year or so, private equity been a fairly low key industry in South Africa so the treatment of private equity was not prominent on SARS' radar screens

"For all businesses, the taxation arena includes – and probably always will – areas that aren't clear cut, with space to manoeuvre within the uncertainty. It may be now, though, with the higher profile private equity is receiving, that Revenue decides to take a closer look and challenge some of the treatments being applied."

Notwithstanding some of the outstanding grey areas, the s9B changes are an important breakthrough for the industry and this clarity may boost support for the assets class, as investors will have certainty on the taxation of their realisation gains. ◆

South Africa's top independent private equity funds hit the road in a big way last year to raise funds. And they were successful to the extent that the industry's funds under management grew to R56,2bn in the year to the end of December 2006, a 32% increase over the previous year-end.

Successful fund-raising in 2006 lifts the amount under management to a record R56bn

This is the key finding of the KPMG and Southern Africa Venture Capital and Private Equity Association (SAVCA) industry performance survey for 2006.

The major fund raisers for 2006, all of which were independents, were Actis Africa, Brait Private Equity, Ethos Private Equity, Sasfin Private Equity Fund Managers, Sphere Private Equity and Treacle Private Equity. Thirty percent of all third party funds raised were from pension and endowment funds, followed by government and aid agencies (22%), insurance companies (19%) and private equity fund of funds (10%). All other sources contributed the remaining 19% of funds raised during 2006.

More club deals?

The quantum of funds under management raises questions about the capacity of the local industry to spend these commitments within their allotted time frames. This suggests that the average transaction size is likely to continue to rise and the market will see more club deals, where ostensibly rival private equity firms come together to facilitate very large transactions.

(This issue of club deals is causing concern in the US and Europe, with the view being that they may reduce competitive tension in large bids. The US Justice Department appears to be looking at the practice, questioning whether it constitutes friendly competition or collusion.)

The quantum of funds under management raises questions about the capacity of the local industry to spend these commitments within their allotted time frames.

Despite the focus on fundraising during 2006, there was also considerable investment activity – in fact, a surprising amount, says Marco Dias, KPMG Associate Director Corporate Finance.

Reported new private equity investments increased by 33% from R4,5bn during 2005 to R6bn during 2006. It is worth noting that DealMakers magazine reports that total M&A activity in South Africa during 2006 was R295bn, a decrease of 16,4% from R353bn during 2005.

The investment activity for 2006 reported in this survey excludes those announced transactions that were still conditional at 31 December 2006. These include the acquisitions by Bain Capital of Edcon (R25bn), Consol (R6.2bn) and Shoprite Checkers by Brait Private Equity (R15.2bn) and Alexander Forbes by a consortium led by Actis Africa and including Ethos Private Equity (R8.8bn). At the time of going to press, the last two transactions were still subject to shareholder and regulatory approvals.

"We expect acquisition activity to be significantly higher in 2007, perhaps even in the R20bn range, though it is difficult to estimate the amount as it depends on the level of gearing in the bigger deals," Dias comments.

The survey reports that at the end of 2006, R26bn was committed by investors but not yet invested by private equity fund managers. This can translate into more than R100bn of transaction value if the typical gearing ratio is taken into account.

Realised gross IRR since fund inception

IRR	0 - 5 years included in IRR calculation		5 - 10 years included in IRR calculation		> 10 years included in IRR calculation	
	2006 No. of respondents	2005 No. of respondents	2006 No. of respondents	2005 No. of respondents	2006 No. of respondents	2005 No. of respondents
Below 10%	2	2	2	2	—	—
10% — 19.9%	1	1	1	2	—	—
20% — 29.9%	1	1	1	1	—	—
30% — 39.9%	1	2	3	1	1	1
> 40%	3	2	1	1	2	2

Source: KPMG and SAVCA Venture Capital and Private Equity Industry Performance Survey for 2006

Performance

As usual with this survey, the gathering of information regarding investment performance proved the trickiest aspect as the lack of sufficient comparative historic data remains a problem in the South African private equity industry. However, levels of disclosure are improving, perhaps as a result of some of the negative publicity that this has prompted.

The 2006 results in the figure "Realised IRRs" (above) include the realised internal rate of return (IRR) levels for 19 respondents, managing R26,2bn/49% of total funds under management at December 31 2006 (2005: R17,8bn/42%). Included are the responses from 13 independents managing 72% of the funds under management by independent fund managers at the end of 2006 (2005: R9.3bn/66%). The realised IRR presents only the returns of funds deployed and subsequently realised and returned to investors. This, therefore, presents a less subjective picture of fund returns than total IRR for realised and unrealised investments. These are gross IRRs and, therefore, reflect returns prior to the payment of expenses such as management fees and carried interest.

The paper "Is Private Equity a Suitable Investment for South African Pension Funds?", based on research conducted by Ivan Missankov, Riaan van Dyk and Werner van der Veen of the Momentum Group, Andrew van Biljon of Riscura (pension consultants) and Mark Hayes of QED Consultants and Actuaries, documented the results of an investigation into the investment performance of a sample of 11 South African private equity funds over a 13-year period. The investigation found that the average aggregate gross IRR for the sample of funds since inception was 34,8%, a performance premium of 18% a year relative to listed South African equities.

Empowerment

On the subject of black economic empowerment (BEE), Dias notes that the vast majority of transactions concluded by the industry have a significant BEE component and the majority of private equity fund managers have a BEE element to their own shareholding structure.

Total funds under management of participating fund managers that themselves are black-owned, empowered or influenced companies (ie, have at least 5% black ownership) increased by 41% from R27,1bn at the end of 2005 to R38.3bn at the end of 2006. This represents 86% of total funds under management if the funds under management by Government Captives are also included. The increase has been largely as a result of the increase in funds under management by empowered fund managers.

Dias adds: "Given the additional clarity provided in the recently gazetted Codes of Good Practice on Broad-Based BEE, as to how a company may treat its ownership arising from a private equity fund as if that ownership were held by black people, the industry is well poised to further increase its already significant contribution on this vital socio-economic process."

Private equity comes of age

Commenting on the results of the KPMG survey, SAVCA Executive Officer J-P Fourie says 2006 will "surely go down as the year in which private equity came of age in South Africa". He says the survey shows that:

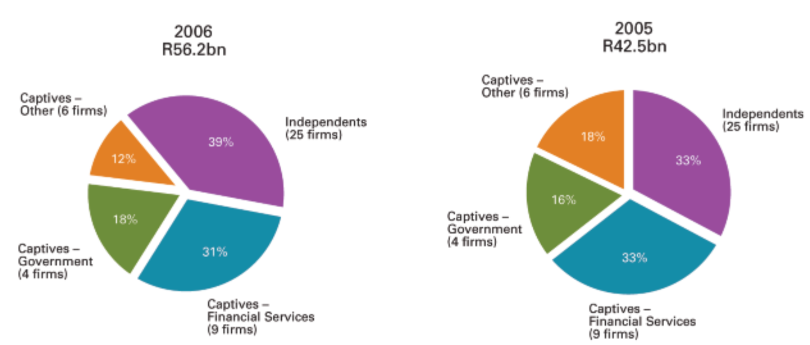
- South African investors are beginning to understand that private equity provides positive absolute returns and significant portfolio diversification benefits
- BEE remains a major source of activity in the industry; there are major moves by industry players not only to transform themselves but also to promote BEE investment into companies
- While venture capital funding is still not at the levels the industry would like, the scale of activity in this sector of the market compares favourably with that in other markets
- The scale of activity in the industry as a whole compares well with that in many major international economies, which bodes well for Government's stated growth targets, as research confirms that private equity investment is a key driver of entrepreneurial activity in any economy.

Looking ahead, prospects for the industry are very positive:

- While 2005 and 2006 were periods of fundraising for many SAVCA members, it seems that, given the announced local and international "mega deals", 2007 and beyond will be years of heightened investment activity.
- The advent of independent mezzanine funds is a positive sign for the development of the industry and the importance of captive and independent mezzanine financing in the facilitation of private equity transactions should not be underestimated.

These are all positive signs for the industry and the country, as private equity investment has considerable impact in terms of productivity, skills development, national competitiveness and job creation.

Total funds under management at 31 December



Source: KPMG and SAVCA Venture Capital and Private Equity Industry Performance Survey for 2006

Highlights of the KPMG survey

- The private equity industry held R56,2bn in funds under management at December 31, 2006, an increase of 32% from R42.5bn the previous year.
- Funds under management have returned a compound annual growth of 9% over the last seven-year period for which this survey has been conducted.
- At the end of 2006 there was R26bn in undrawn commitments available for future investments, an increase of 63% from the R16bn in undrawn commitments at the end of 2005.
- Independents increased their total funds under management by 58% from R13,9bn at the end of 2005 to R22bn at the end of 2006.
- Captives – Financial Services' funds under management increased by 26% from R13,9bn at end 2005 to R17,5bn at the end of 2006.
- Captives – Government's funds under management increased by 44% from R7bn at December 31, 2005 to R10,1bn at end 2006.
- R11,2bn was raised during 2006, representing almost as much as the aggregate amount raised between January 2001 and December 31, 2005.
- 50% of all funds raised during 2006 were from US sources; as a result, America has overtaken Europe as the highest provider of foreign funds to South Africa.
- Investment spending by private equity firms is up 33% from R4,5bn during 2005 to R6bn during 2006. This excludes the mega-MBOs/LBOs announced during the last quarter of 2006 but that were still conditional at 31 December 2006.
- R6.4bn, excluding VenFin's disposal of its interest in Vodacom for R16bn, was returned to investors during 2006. This represents an increase of 59% from 2005 and surpasses the previous record of R4bn recorded during 2004.
- Investment in entities that are black owned, empowered or influenced is up 22% from R3,1bn during 2005 to R3,8bn during 2006.

CASE STUDY

In many ways, the Kelly Group investment exemplifies the classic private equity transaction - acquisition, delisting, several years of building and growth, then relisting.

The Kelly story - exemplifying classic PE transactions

John Gnodde

But one significant area of differentiation from the norm, says Brait executive director responsible for this investment, John Gnodde, is in the significant management changes made after acquisition.

The assets and liabilities were acquired by the Brait Funds in April 2001 from the former owner LogicalOptions for a consideration of R616m.

"Before we bought the group out of the unbundling of Educor," Gnodde says, "we recognised that it was significantly underperforming and that it would take some time to turn around. But we took a long term view as we could see the potential. The critical thing is that we understood the risk and were, therefore, able to manage it.

"We had identified it as a company with a number of strong brands, but it was clear that they weren't focusing adequately on their core business, that of outsourced staffing. Yet with the improvement in the economy we could see that the staffing sector should have been benefiting."

This strategic incoherence meant that the non-core brands were cannibalising each other and were a source of unnecessary distraction, preventing the primary businesses from taking advantage of some obvious opportunities. So the new owners sold off five businesses in the US and three in South Africa.

There were also some major management changes and this is one of the aspects that Gnodde highlights as differentiating the deal from the 'average' private equity buyout. "Usually one of the attractions of a prospective buyout is that strong management is already in place. However, it was our view that to take this business forward, a new CEO and CFO was required."

Thus, within six months of acquisition, CEO Malcolm McCullough, previously an executive director of Murray & Roberts Limited, was appointed and new financial director Johan du Toit, recruited from Educor. At the same time a strategic stake in the company was sold to management and a BEE shareholder was introduced in the form of Safika Holdings, in terms of which Brait Funds sold a 28% interest in LogicalOptions to a trust, of which Safika was a beneficiary on a vendor-financed basis.

Other steps in the turnaround included:

- The reformation of the business into three core divisions;
- A complete overhaul of the group's management information systems; and
- Macro-economic factors - there was a general economic recovery in the key South African and North American markets which assisted in restoring and creating a sustainable platform for growth;
- Strengthening of skills at board level.

Rolf Hartman, a director of Brait Private Equity, agrees that there "was a lot of hard work to be done" and that this was best suited to the private environment. "We could move as quickly as we needed to get things done – without the pressure to show instant returns."

In September 2005, Grenville Wilson (formerly chief executive officer of the then JSE-listed car hire and fleet management group Avis Limited) was appointed as the new CEO, with the aim of building on the strong results that had been achieved and positioning the group for a potential listing.

"Grenville was familiar with the listed environment and was a strong brand man so it was appropriate for him to have taken over at that stage," says Gnodde.

Then in August 2006 the group changed its name from LogicalOptions Staffing to the Kelly Group and announced that it was positioning itself for a JSE listing in 2007.

Wilson said it was "time for us to list and restructure the balance sheet and pay our debt. This will also give investors a share in the growth of a company that has a highly positive cash flow." He added that the group was going back to the market to raise funds to repay its debt at a time when the market was strong.

In terms of the initial public offering, which took place in April this year, the company was listed on the JSE Limited, with Brait diluting its shareholding to retain a share of 10,9% once the sale to the broad-based BEE group has been concluded.

After the listing, the company's largest shareholders and their holdings were Brait Private Equity Funds (20,9%); Safika Group (16,8%); management, staff, directors and Frontline vendors (24,2%); Coronation Asset Managers (4,4%); Old Mutual (4,2%); Stanlib (4,0%) and RMB Asset Management (3,1%). As undertaken in the listing documents, Brait is finalising the sale of a further 10% to a new broad based empowerment group, which includes existing BEE shareholder Safika.

The listing followed a substantially oversubscribed private placing in which a range of institutional and retail investors took up 38 605 544 Kelly Group shares at R9 each for a total value of R347,4m. To assist further in meeting in market demand, in terms of a separate agreement, the Brait Funds sold an additional 3,9m shares at the placement price to existing Kelly directors and management. Furthermore, to assist in securing the company's BEE credentials into the future without diluting new shareholders, Brait Funds sold 10m Kelly shares to Safika Holdings (Pty) Ltd at the placing price.

The proceeds of the listing were utilised to repay the shareholders loan from Brait to Kelly, de-gearing the company apart from R100m receivables securitised facility.

Today, with brands including Kelly, PAG, Accountants On Call, Renwick, Kelly Industrial and InnStaff, the Kelly Group is one of South Africa's leading providers of outsourcing, recruitment and consulting services. It is to be found on the JSE's main board in the Support Services - Business Training and Employment Agencies sector under the name "Kelly."

Private equity fund managers do themselves a disservice by not better understanding the needs of prospective investors. That's the view of Cora Fernandez, deputy CEO at Sanlam Private Equity.

Information and regular communication are the way to attract new investors

"It's no secret that fund managers the world over battle with the amount of information the market would like from them," says Fernandez. "But they need to recognise that it is in their own interests to be more forthcoming. In this way they are likely to widen their pool of prospective investors, as well as better satisfying their existing ones."

The common structure for an independent ('third party') private equity fund is a limited partnership, which bring two parties into play: the limited partners (LPs), who are providers of capital and have limited liability, and the general partners (GPs), who are the investment managers of the fund.

Fernandez says Sanlam Private Equity has been on the road with four different sets of fund managers raising funds in recent months and the feedback has been worth reporting. "We have been targeting both the traditional private equity investors and the non-traditional investors. It is evident from this initiative that education in this asset class is vital to unlocking growth. This will allow us to expand and diversify the class away from the traditional large managers, who hold a significant base of 'almost captive' inter-

Cora Fernandez

national and local investors, primarily as a result of their performance track records. This market needs a healthy combination of large, medium and specialist fund managers, as well as more venture capital managers – which is currently does not exist.

"Part of our role has been to try to encourage some of those not experienced in private equity investment among the short term insurers, life companies and pension funds. But these bodies have a vast array of requirements and demands, over and above the normal management fee and liquidity concerns."

Fernandez says the reporting structures utilised by the private equity funds is new to first-time LPs, does not gel with their needs, and they require more regular reports and valuations than the customary quarterly reporting by private equity managers.

They are unaware of the different types of private equity funds available; most of the prospective LPs only know Ethos and Brait, but had no knowledge of the various other options open to them. "There also appears to be no desire to diversify their private equity portfolios to include specialist and venture capital funds.

"We know the tendency for the GPs is to operate under a veil of secrecy with limited if any information shared with the press – apart from where it is mandatory – but they really need to market themselves better, selling the benefits of each deal, each fund, starting with detailed rationales behind each acquisition, through to the macro benefits to the economy derived through the entire lifecycle of the fund. This will go a long way towards educating exiting and prospective investors on the asset class.

"Now would be a good time for them to start to go against the 'traditional' way of doing things," Fernandez concludes, "such that we dispel the current misperceptions about the asset class and defuse some of the irresponsible commentary we've seen in the media. Let the GPs educate the market, since they're the ones that know best."

Or should do, anyway. ◆

Thierry Dalais went from the glare of functioning as part of a listed company to the somewhat lower temperatures of a private operation – and appears all the happier for it.

Finding their Métier out of the spotlight

Dalais left Brait, where he had been a founding partner, to co-launch specialist investment and advisory firm Metier some three years ago. Today the company remains, by choice, low profile, but is increasingly a force to be reckoned with in the private equity and investment banking market.

"We're an investment house in its truest sense," says Dalais, "capitalising on value opportunities and participating in the growth and development of those investments by bringing into play the multi-disciplinary skills of our team."

Dalais says the firm has caught the attention of some top drawer private equity investors in South Africa. It has partnered with empowerment firm Lereko in establishing the Lereko Metier Capital Growth Fund, for which it is has already had one closing and is currently raising further commitments. Dalais is not able to disclose either the actual or target size at this stage, given that fundraising is still underway. However, he assures *Catalyst* that it is 'relevant and material.'

"We spent a considerable amount of time putting the building blocks in place to ensure that once we got going on the private equity fund we would be in a position to hit some sweet spots and keep up a higher than average investment rate.

"The fund is investment-ready and has been organised to go after mid-market buyouts and growth capital opportunities investing up to R500m of equity in a single transaction." The fund does not rule out larger transactions but this would require

Thierry Dalais

co-investors. It has already begun investing and has made a few investments.

The fund principals are former government heavyweights Popo Molefe, Valli Moosa and Lulu Gwagwa, Paul Botha, Anthony Hewat, and Thierry Dalais. Botha and Hewat have both worked with Dalais since the days of Capital Partners, which merged into the Brait group in 1998, and the two of them co-founded Metier with Dalais in 2004.

The firm (Metier) has acquired a reputation for supporting the investment programmes of groups such as Royal Bafokeng, RMB, Tiso, Medu, Absa Barclays and Blackstar, and has successful co-investment relationships with these firms.

Some of the transactions and activities in which it has been involved are:

- Datapro (listed on the JSE's AltX). The company says it has been instrumental in Datapro's growth in market capitalisation from R200m to more than R2bn in less than 18 months, including involvement in the capital raising of about R500m. Metier, its affiliates, network partners and the Lereko Metier Fund today hold close to 30%;
- It raised US$1,5bn for Econet's financing of its bid for Vee Networks in Nigeria;
- It arranged the sale of African Life to Sanlam;
- It advised on the secondary listing of Datatec on the AIM board of the London Stock Exchange;
- It is involved in the management of the investment trust established to provide long term sustainable funding support the LoveLife youth and HIV awareness programmes, the largest of their kind in South Africa.

In addition, through its buyout work the group is a source of debt origination for which there has been an increasing appetite in recent years. This year alone Metier has been closely involved in three transactions with around R1,5bn of debt having been placed in each.

"We consider ourselves to be an agile and serious partner to our clients. We do what we can to be relevant value-adding partners and we are organised to take on and manage risk," Dalais says. "Metier has some really good opportunities ahead of it and I expect we will keep on growing."

Talking about the South African private equity market in general, Dalais believes that the strong market performance of recent years has been good for the private equity players. "The poor market conditions prior to the current run didn't do much for the development of the private equity market here." He believes this has exposed the market to foreigners as a reasonably-priced investment destination when compared with other markets, given the macro-economic fundamentals generally promoted and believed by investors in South Africa.

> **The firm has acquired a reputation for supporting the investment programmes of groups such as Royal Bafokeng, RMB, Tiso, Medu, Absa Barclays and Blackstar, and has successful co-investment relationships with these firms.**

"The South African private equity market will develop like others around the world. I hope we don't get cast in a poor light as has happened in a few other places – this would be unfortunate, given the good work that many private equity investments teams undertake," he concludes. ◆

One of the largest unions in the US has taken on the private equity industry, criticising the sector for not doing more to measure the impact buyouts have on jobs and communities. It has released a study, '*Behind the Buyouts*', which dissects private equity and recommends a set of principles for the industry.

Unions step up to challenge private equity

The Service Employees International Union (SEIU), which represents about 1,8 million workers in the US and Canada, is the fastest-growing union in North America, the largest union of health care workers, property services workers, and the second largest union of public services workers. Its members participate in pension funds with more than $1 trillion in assets, most of which invest 5-10% of their assets in private equity.

It says, in commentary that will resonate in South Africa too: "The private equity buyout industry, armed with more than a half-trillion dollars of capital, is today engineering financial deals that together are larger than the annual budgets of most of the world's countries. This financial juggernaut is generating hefty returns to its investors, extraordinary riches for its executives, and newly relevant questions about the impact of its business practices on American workers, businesses, communities, and the nation.

"The private equity industry's profits come during a period of historic income inequality in America. There is no doubt that the income being accumulated in the buyout business is a major contributor to the concentration of wealth among the top 1% of Americans. Yet questions about the role the private equity industry could play in addressing this national challenge remain—until now—unasked, and unanswered.

> **"There is more than enough wealth in the private equity industry for the buyout firms to continue to prosper while also adapting their business model to expand opportunities to benefit workers, communities, and the nation."**

"There is more than enough wealth in the private equity industry for the buyout firms to continue to prosper while also adapting their business model to expand opportunities to benefit workers, communities, and the nation."

The SEIU recommends the following principles for the private equity buyout industry:

The buyout industry should play by the same set of rules as everyone else

- The industry should provide transparency and disclosure about its businesses, its deals, income, its plans for the companies it buys and sells, and the risks of the debt it loads onto portfolio companies;
- The industry should invest in the health, security, and long-term prosperity of America by supporting equitable tax rates and the elimination of loopholes that increase the tax burden on working Americans;
- The industry should work to build confidence in the securities markets by eliminating conflicts of interest and other potential abuses in their deals.

Community stakeholders should have a voice in the deals and benefit from their outcome

- Buyout firms should play a proactive and constructive role in the communities affected by its deals;
- Community stakeholders should be involved as deals are being made;
- The private equity buyout industry and community stakeholders should use wealth generated by deals to improve the quality of life, the environment, the health, the safety, and the long-term stability of communities.

It notes that the biggest five private equity deals together are larger than the annual budgets of all but 16 of the world's largest nations. The five biggest deals involved more money than the annual budgets of Russia and India. And the annual revenue of the largest private equity firms and their portfolio companies would give private equity four of the top 25 spots in the Fortune 500, with KKR cracking the top 10.

It says this "financial juggernaut" is generating hefty returns to investors, and extraordinary riches for the top executives of private equity firms. "Though exact figures are hard to come by, the hallmark of the private equity industry is the incredible wealth being created for the small number of individuals who drive the buyout business."

However, it adds that the amount of information available about these firms and what they do with their wealth is limited. Unlike publicly traded companies that are subject to federal securities laws and regulations as well as to daily scrutiny by financial analysts and the business media, private equity buyout firms operate virtually free of oversight and public accountability, their profits and practices largely hidden from view. Far from a coincidence, this lack of transparency is built into their business model, providing buyout firms with investment advantages that publicly traded companies do not enjoy.

This is where the South African private equity industry might be concerned, since the issue of transparency and availability of information is one of the frequently-cited problems facing the sector.

In other union-related private equity commentary, the United Auto Workers (in the US) laid into the buyout firms circling Chrysler, criticising them for 'stripping and flipping' companies. Chrysler has now been bought by Cerberus …with UAW support!

In the UK, the industry has also come under attack from unions. The influential GMB union recently wrote to UK legislators saying it "opposes the unregulated and unaccountable activities of venture capitalists, their ability to get tax relief on loans, and the effect they have on companies, jobs, pensions and the economy".

It said private equity firms should be regulated by a tough watchdog capable of restricting their negative social and economic impact. The union has attacked private equity firms for profiteering at the expense of workers and communities, and calls for more regulation of the industry.

> **The (British) union GMB wrote to UK legislators saying it opposed "the unregulated and unaccountable activities of venture capitalists, their ability to get tax relief on loans, and the effect they have on companies, jobs, pensions and the economy".**

In South Africa, union response to the sector has been muted, which is surprising given the hype around the sector in the past year and the large number of workers impacted by the mega deals underway. Cosatu did not respond to *Catalyst's* requests for comment. ◆

The traditional private equity fund model has had little place for individual South African investors, given the extremely high barriers to entry. Yet many people have been asking how they can get in on the action.

Making it easier for individuals to get in on private equity

This is where the fund-of-funds approach has application … which led to the formation of the Momentum Private Equity Fund of Funds, aimed at high net worth individuals (HNWI), non-taxable institutions and small to medium-sized retirement funds (either pension or provident) that wish to include private equity in their portfolio mix. Launched in August 2003, it was the first product of its kind in South Africa, though Old Mutual last year followed with its Old Mutual Multi Manager Private Equity Fund (OMMPEF).

The Momentum fund has a minimum investment of R1m, while the Old Mutual product has an entry level of R50 000.

"We saw the returns being generated for individuals through private equity in the UK and asked ourselves why, with our exceptionally strong retail distribution network, we should not be able to do the same here," says Momentum private equity manager and actuary Ivan Missankov.

The Momentum fund is co-managed by fellow FirstRand entity, RMB Private Equity, one of the top private equity teams in South Africa.

The fund has a minimum contribution of R1m, with 12 years to maturity. There is no surrender value during the first five years and thereafter surrender is at a large discount to fund value, highlighting the long term nature of such an investment. However, as the underlying private equity investments are realised during the life of the fund, the proceeds may be returned to investors in the form of partial maturity payments. There are no guarantees attached to returns.

The fund would suit those who:

- Would like to benefit from the risk/return characteristics of private equity, while at the same time diversifying their investment portfolio;
- Have a long-term investment horizon and are prepared to exchange short to medium-term liquidity for attractive potential returns;
- Understand the nature of alternative investments in general and private equity in particular.

"Private equity investments have historically been the preserve of a select few institutional investors, because of the limited range of potentially top-quartile performing funds, and the large minimum investment required by such private equity funds," says Jake Archer, senior manager at RMB Private Equity.

"It made sense for the FirstRand group to create an additional avenue for taking advantage of some of the good private equity investments in the market when RMB has already reached its prudential limits, while also developing a retail product."

Missankov notes that there was some initial scepticism about the asset class among the target market, relating to, for example, concerns about liquidity, corporate governance and disclosure – the same challenges thrown to the industry from some of the larger investors, in fact – and initial take-up was slow.

"I think it was ahead of its time. But once the concept became better known interest strengthened considerably and demand has been incredible over the last two years. The fact is that, in terms of the pension funds, they do what their consultants advise and the consultants needed to take time to get used to the 'new' asset class and see a track record."

The Momentum fund is closed to new investment, though Missankov says the team is now working on a new product.

One key difference between this and a conventional independent private equity fund is that here the full contribution is made up-front, rather than on a commitment and deal-by-deal drawdown basis. Prior to investment the funds are managed by Momentum in a combination of money market (and money market equivalent) investments and private equity assets.

The fund is invested in Ethos Funds V and IV, Tiso I, Sphere I and Brait IV. In terms of direct investments, it is in Fuel, Life Healthcare and Robor, while internationally it has a stake in MCM China.

A look at performance in its last report (to end December 2006) highlights the cyclical and long term nature of private equity investment – and why private equity firms are reluctant to disclose returns on a short-term basis.

The fund was valued at R593,4m at end December 2006, having returned 22,3% for the previous six months. Performance from inception was 169,2%, which translates into an annualised return of 33,6%.

The fund's investments, excluding the cash component, returned 45,5% for the six months, and performance since inception was 370,0% or 57,3% p.a. However, this has been during a period of exceptional market performance and the managers warn that this has been an unusual time and is not expected to continue.

Given the substantially lower entry level of the OMMPEF, it clearly aims to attract a broader market than the Momentum fund. Mark Gevers, Head of Private Equity at Old Mutual Investment Group (SA), says the OMMPEF is pitched at individuals looking for an attractively-priced private equity retail offering with debt leverage, liquidity, diversification and cash yield minimisation strategies.

The underlying managers of this multi-manager fund are Old Mutual Alternative Investments, Brait and Ethos.

Based on the December 31 2006 untaxed unit price valuation of R1.3898, the investment vehicle delivered 39,1% in the eight months from inception.

While the product contains specific liquidity rights via a market-making underpin provided by Old Mutual, a fully-committed investor can expect to be paid out fully at the latest by end December 2016.

Business Partners International Limited (BPI) and the International Finance Corporation (IFC) have launched a new investment fund for Kenyan entrepreneurs.

SA's Business Partners and IFC launch investment fund for Kenyan entrepreneurs

BPI is a wholly-owned subsidiary of South African Business Partners Limited, this country's leading investment company for small and medium enterprises. The US$15m Business Partners International Kenya SME Fund will provide investment financing, added-value solutions and technical support for locally-incorporated small and medium enterprises. It will be managed by a team of Kenyan specialists based in Nairobi, with support from the corporate structure of Business Partners in South Africa.

BPI was established in 2005, backed by the IFC and other parties such as the CDC Group plc, the European Investment Bank, the East Africa Development Bank and the Transcentury Group, as well as Norfund, the Doen Foundation and the Assurance Reassurance Omnibranche in Madagascar.

"The Business Partners investment model is internationally recognised as the most effective for use in developing economies," says Mark Paper, BPI's Chief Operating Officer. "This has certainly proved true in South Africa over the past 26 years and, more recently, in Madagascar, where we launched the first BPI investment fund in 2005.

"What makes the Business Partners' financing model unique – and so innovative in Kenya – is that BPI makes equity investments based primarily on business viability and the vision, drive and experience of the entrepreneur, and has different criteria than other financial institutions," says Paper. "Approval of applications is not reliant on the entrepreneurs' own contribution or available security".

Any suitably-qualified entrepreneur with a viable business plan may apply for investment financing through the fund. For successful candidates, investment deals are then custom-financed, based on the needs of the business, its potential and on any own contribution or security the entrepreneur is able to offer.

"As importantly, BPI invests in companies across all sectors, with the exception of farming operations, on-lending operations and non-profit organisations, " says Paper. "Most of its investments are expected to be made in the manufacturing, retailing, franchising, services, travel & tourism, leisure and marine fishing sectors." ◆

The annual GIBS/SAVCA Foundation Programme is playing an increasingly important role in education about private equity and venture capital in South Africa.

The GIBS/SAVCA annual private equity and venture capital course

This year's three-day course, from Wednesday, June 13 to Friday June 15, will take delegates through the whole venture capital/private equity investment process. Using lectures, case studies and panel discussion, it will include:

- The current state of the market;
- Deal generation – sourcing winning deals (identification, evaluation, selection);
- Business evaluation – deal structuring and pricing;
- Due diligence and the risk management process, how to ensure good pre-investment evaluations;
- Distinguishing characteristics of different types of VC/PE finance;
- Highlighting the role of debt capital in private equity transactions - focusing on mezzanine financing and high yield instruments;
- Managing the exit – options for the exiting of investments;
- Post investment and exit problems;
- The venture capital market in South Africa - why is it important, how is it different to private equity;
- Valuation of early stage high growth ventures;
- Guidelines for structuring funds, evaluating funds and reporting fund/portfolio performance;
- Private equity and Black Economic Empowerment;
- Legal and governance - the regulatory environment.

The course takes place at the Gordon Institute of Business Science, 25 Fricker Road, Illovo, Johannesburg, at a cost of R7 500 per person for SAVCA members and R8 500 for non SAVCA members. For further information contact Valeria Wastell at wastellv@gibs.co.za. ◆

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