Vol 4. No4 DECEMBER QUARTER 2008

Catalyst

GOLD MEDAL ISSUE

SA's quarterly Private Equity & Venture Capital magazine

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In a deal that highlights our expertise and experience in the telecommunications sector, Rand Merchant Bank is proud to have been co-advisor to Government in the recent transformational deal between Telkom and Vodafone in respect of their shareholdings in Vodacom.

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Catalyst

From the Editor's desk

If 2007 is remembered as the pinnacle year of the private equity industry in South Africa (and the world, too) then 2008 will be marked down as an annus horribilis. The year was marked by a hard-landing for the industry as funding taps starting running dry and debt became a dirty word after the now infamous subprime meltdown in the United States. The ensuing fear and panic triggered an unprecedented collapse of confidence, reverberating through every layer of the global financial landscape. The question everyone's asking is when will this end?

As Luc Albinski says in his erudite exposition of mezzanine funding on page 6 – 8, the funding taps have run dry. But there is opportunity in every cycle and, as was shown by Actis during 2008, those funds with undrawn commitments can still uncover a great deal. Exceptional assets lie scattered in the wake of the global financial system's wreckage, available at bargain prices.

For now though, and with the increasingly opaque crystal ball tucked away in the drawer next to this year's election schedule, private equity general partners and fund managers appear to be keeping their heads below the parapet. The advice from all corners is to keep calm and ensure that investee companies are running with flexible efficiency. In many cases, this means trimming the fat and deleveraging where possible.

During the Great Depression, as legend has it, many young men who were down on their fortunes chose to hop aboard a freight train and "ride the rails" in search of better chances. The popularity of this mode of travel partly stemmed from the fact that the trains kept running through the Depression, presumably because they managed to stay profitable through those hard times, birthing the phrase "these trains are bound for glory." Fast forward 80 years and well-managed businesses will surely ride a similar course once the pendulum of gloom swings the other way.

Many congratulations to the Actis team of John Van Wyk, Jonathan Matthews and Jacob Hinson for winning the Catalyst Private Equity Deal of the Year for 2008. This was a feat made sweeter, I'm sure, given the perilous dealmaking conditions during the year. The Dom is always dryer in victory.

Michael Avery
Editor

Catalyst

Publisher: David Gleason

Editor: Michael Avery

Design & Layout: Janine Harms, Gleason Design Studio

Catalyst is published by the proprietor Gleason Publications (Pty) Ltd, reg no: 1996/010505/07 t/a FABCOS Publications from its offices at 30 Tudor Park, 61 Hillcrest Avenue Blairgowrie, Randburg 2194. The company is a member of the Fabcos Group

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Contents

Actis pulled off the private equity deal of the year in arguably the best defensive sector in which to be positioned in South Africa (or anywhere for that matter) during a protracted global economic downturn: power generation and supply.

Simply sparky

At a time when private equity dealmakers were sitting on large undrawn commitments but choosing to take the wait-and-see approach, the team at Actis, led by John van Wyk, decided to swim against the tsunami of negative sentiment and lead a buy out of Alstom South Africa – a major electrical engineering, manufacturing, distribution and contracting business – for R5,16bn.

The deal had its genesis in the decision by French owners Alstom France and Areva to exit their positions in Alstom SA by way of an auction as is often the case in transactions of this nature.

Alstom South Africa is a large diversified business with its principal activities in manufacturing, distribution and contracting in the electrical engineering sector of the economy. The company employs in excess of 6 000 people and has an annual order intake of R5bn. It has 27 operating units, 22 production facilities and 25 distribution centres throughout South Africa.

Significantly, Alstom SA has been operating in South Africa for more than 100 years and has a strong reputation as the leading supplier in its chosen markets.

Rand Merchant Bank advised on the transaction, which was funded by a combination of conservative debt by the standards set in 2007, and equity funding, with Nedbank underwriting the debt component of the transaction.

Actis and Old Mutual Investment Group (OMIGSA) partnered management and existing Black Economic Empowerment (BEE) partners, Kagiso, Tiso and a private black investor, in the company which is expected to benefit from increased infrastructure expenditure in the South African power distribution sector. It is well placed to play a key role in assisting the power sector in addressing the major backlogs presently existing in the electricity transmission and distribution networks.

As part of the transaction, Alstom SA will sell its power service subsidiary, (which provides maintenance, spares and after sales services for turbines and generators), back to Alstom France and the repair services business will remain with existing shareholders.

John Van Wyk, Jonathan Matthews & Jacob Hinson

Actis director Jacob Hinson said it would have been nice to hold on to the power service asset but explained that the French sellers Alstom and Areva wanted to retain this.

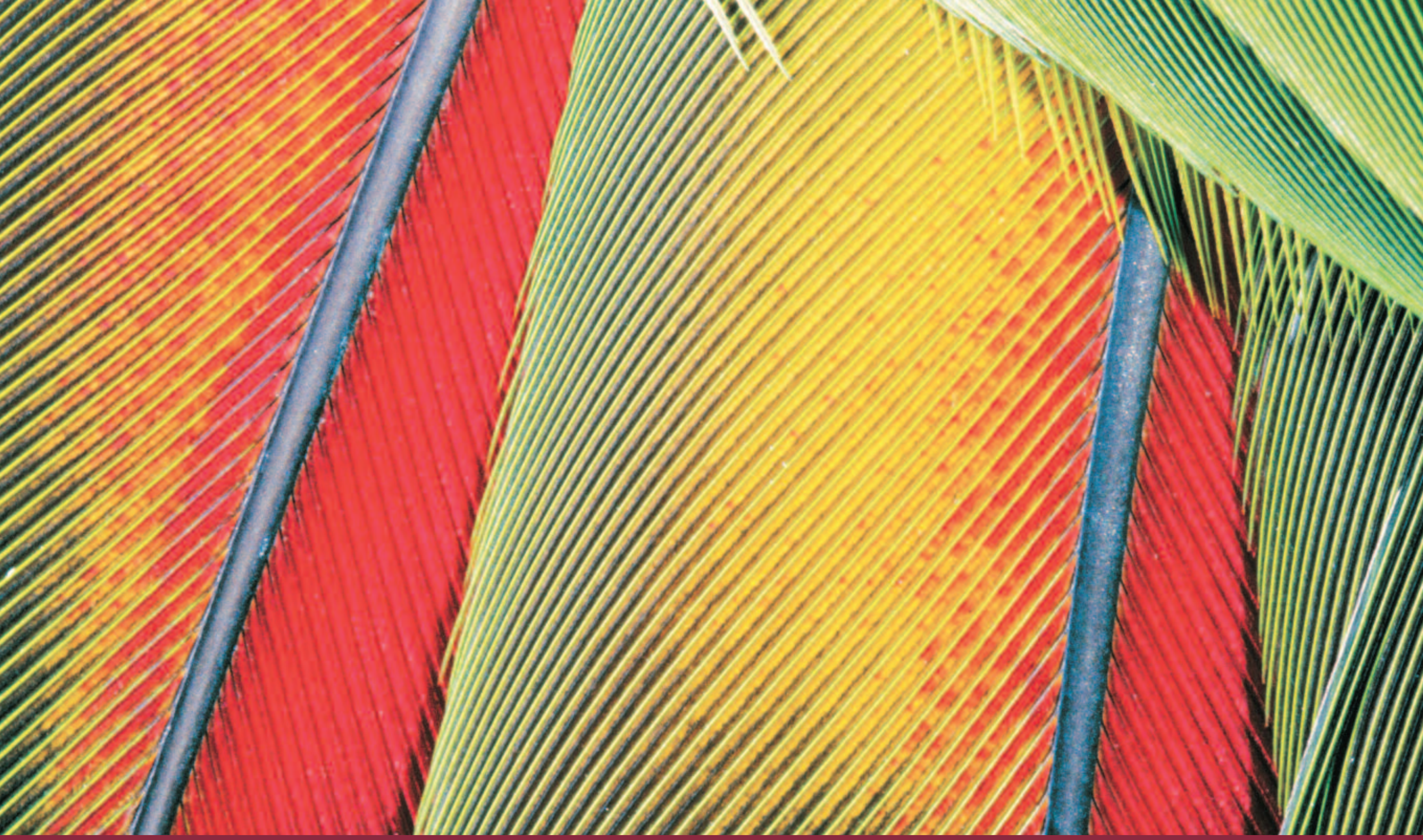
PE transactions are often based on a value-enhancing proposition. The Alstom deal will see management retained and little changed in terms of the operations of the business. However, Actis partner, John Van Wyk, believes that the business isn't in need of a major overhaul necessarily, merely some fine-tuning.

"Whenever we go into a transaction we always try and have a pretty good idea of what we can do to improve the business and what the game changing strategies are," explains Van Wyk. "So we invest an enormous amount of time and energy in first of all understanding the space and secondly identifying what the opportunities may be post the investment. Part of that is the reason that we were able to outbid a trade buyer when we bought the business. Under normal circumstances trade buyers would have synergistic benefits and advantages."

Van Wyk is confident that Actis will provide the right mix of global expertise and local knowledge.

"First of all we've got an extremely well developed footprint in the rest of Africa. So when we invest in any of our business in South Africa we have a look at what the opportunities are with our other businesses in Africa. And obviously we engage with management to see how we can drive initiatives.

"We also adopt a more sectoral approach to our investment philosophy, which, when looking at the global financial crisis, is a lot more long term. This business is exceeding our initial expectations and it's



Actis Emerging Markets 3
US$2.9 billion

A pan-emerging markets fund to invest in private equity opportunities in Asia, Africa and Latin America

December 2008

www.act.is

Actis
The positive power of capital

all borne out by the domestic infrastructure spend," enthuses Van Wyk.

"We bought the business a few months after all the power problems emerged and we all know that there's less pressure on the system now; there's slightly more capacity and less demand. But the reality is that they (Eskom) still need to add capacity over the next ten to fifteen years. So we see many opportunities in that space."

One of the most pressing strategic questions that Actis had to answer was whether Alstom was susceptible to dumping by international competitors – especially Chinese manufacturers. Van Wyk outlined several areas that positioned Alstom in a near dumping-proof space as it were. For one, several of the components that Alstom supply in the grid cannot simply be replaced with a Chinese component due to integration concerns and specification subtleties.

"This business is exceeding our initial expectations and it's all borne out by the domestic infrastructure spend"

Second, Alstom's primary clients, such as Eskom, are obliged to buy local and empowered, which also provides a strategic advantage. And local manufacturers have been boosted by the fall in the rand against the dollar making imports less attractive.

Gazing into the future in the current environment is fraught with uncertainty for most but van Wyk and his team – minus Garth Jarvis who resigned after the Alstom deal – are confident of their position to find and conclude similar large transactions over the next few years.

This is partly due to good fortune as Actis managed successfully to close its US$2,9bn (R30bn) private equity fund, Actis Emerging Markets 3 (AEM3), before the funding taps ran dry – this is one of the largest dedicated emerging markets private equity funds closed in 2008 and doubles the amount raised by Actis in 2004. However, Actis' primary advantage is due to its position as a leading player in markets that are in infrastructure bull cycles and will present many opportunities to those with the cash already in the bank. ◆

Profile

Mawuli Ababio, managing director, and Bonita Ellison, a consultant, of the African Venture Capital Association outline its mandate

Emerging Africa

Africa's reputation as a risky and forbidden investment destination is gradually giving way to acceptance as an emerging market giant much in the same tradition as China and India.

According to the OECD, funds raised for private equity in sub Saharan Africa trebled in 2006 to US$2,3bn. EMPEA's analysis of fundraising trends for the first half of 2008 indicates sub-Saharan Africa raised US$1,2bn, and the continent is well on its way to surpassing previous levels. While these levels may be far behind those in the OECD countries and "Emerging Asia" in terms of contribution to GDP (less than 0,01% of GDP) they are not far behind fundraising levels in Latin America. Several politico-economic factors have contributed to this phenomenal improvement in perception of, and hence interest in, Africa by emerging market investors.

Early initiatives

Africa's first wave of private equity funds (early stage) started in the mid-1990s strongly supported by Development Finance Institutions (DFIs) (notably IFC, CDC, FMO and OPIC). These earlier funds, as expected, generated mixed results. Despite this, the same DFIs committed additional resources to new fund managers and helped establish an environment conducive to private equity.

This interest has also extended to global investors looking at emerging markets and, more importantly, African Limited Partners looking to increase their portfolio allocation to the asset class. However, the advent of democratic and economic reforms since early 2000, coupled with strong growth rates in several countries has spurred further interest in the region. Over the period several SME focused venture capital funds such as Aureos, Tuninvest, Tunisia (which appears to have been in fundraising mode from inception), African Capital Alliance in Nigeria and Venture Partners in Botswana have emerged as experienced GP teams. In addition, several newer fund managers, such as Phoenix Capital Management (Cote d'Ivoire), Vectis Capital and Travant (Nigeria), have been in fundraising mode.

Some of the larger and more experienced pan African players (Emerging Capital Partners, Actis, Helios and Kingdom Zephyr) have also demonstrated the capacity to generate sizeable deal flow and returns. During the last month or so Emerging Capital Partners (ECP), which is targeting a record US$1bn for its latest pan Africa vehicle, announced a first close of US$523m.

And in July, Kingdom Zephyr announced that Kingdom Zephyr Africa Management (KZAM) raised US$325m for its PAIP II fund. The PAIP I had an IRR of 92%.

The phenomenal increase in investment interest is attributed to:

Real GDP growth rates in sub-Saharan Africa, which have averaged between 5% and 7% in recent years (with the IMF predicting 6,5% growth this year), and inflation and interest rates, which have fallen to single or low double-digit levels in recent years

- Record high commodity prices for most African country exports
- A marked improvement in governance and the policy environment
- The global economic initiative to aid heavily indebted poor countries (HIPC) which has helped reduce foreign debt stock, facilitated sovereign risk ratings and allowed central banks to accumulate foreign reserves
- Increased competition in European and US venture capital and private equity markets has made African investments more attractive
- Recorded return multiples delivered to LPs by market leaders such as Emerging Capital Partners, Actis and Kingdom Zephyr.

Africa's reputation as a risky and forbidden investment destination is gradually giving way to acceptance as an emerging market giant

The prognosis remains optimistic despite the recent volatility in global equity and credit markets and against this context the African Venture Capital Association (AVCA) is at the forefront championing and promoting venture capital and private equity as the key to sustainable growth in Africa.

AVCA plays its part

Formally registered in 2000 with strong support from the Netherlands Development Finance Organization (FMO) in conjunction with 10 African fund management companies, the African Venture Capital Association's (AVCA's) membership is split between:

- private equity and venture capital firms and persons active in making principal equity and equity related investments in Africa (full members);
- and professional firms and individuals who can influence and or support the development of private equity and venture capital in Africa. This latter group includes, but is not limited to, pension funds, insurance companies, regulators, accountants, lawyers, consultants and advisors (associate members).

Over the last five years, AVCA has experienced remarkable growth in its membership and prominence in the African financial sector. This growth largely reflects: first, the growing interest by global and regional investors in this asset class in Africa; and, second, the introduction of a set of initiatives designed to deliver value to the membership. From an initial group of 15 members,

AVCA, as at August 2008, had 120 members from some 18 regional countries and nine countries internationally.

Members together have over €5bn in managed funds. This growth has taken place in spite of limited sources (limited funding and a small secretariat supervised by a volunteer board/executive committee).

Advocacy

Against the backdrop of Africa's burgeoning emerging market, several challenges exist for such an association within the African context. These challenges present opportunities for the AVCA to make an impact on the venture capital and private equity industry in Africa, while becoming a member-centric organization. Notable among these are: the need for credible information on industry trends, the need to champion best practices and advocacy, the need to establish an industry identity for Africa, networking, and creating a sustainable organization.

Credible information

Hard data and comprehensive industry information is not readily available for the African market and AVCA has set out a strategy to become a knowledge centre for the industry. Just as other regional associations (EMPEA and LAVCA) have devised methodology for collecting data on fundraising and investments levels, AVCA is (in conjunction with KPMG Africa) producing a comprehensive Annual Investment Activity Report to cover 2006-8. This document will capture information on trends in the venture capital and private equity industry for all of Africa (excluding South Africa). The data will form the basis for effective lobbying of governments for incentives and policies at a local and global level and presenting a full blow case for the merits of encouraging this activity in Africa (in terms of GDP growth, exports, employment, etc).

Ababio

In addition, AVCA is also producing an Annual Members directory which contains information on all active members including profiles, funds under management, deal size etc. Both these manuals are viewed as essential for attracting potential investors to the table.

In the near future, information gathering efforts will also include tracking the activities of global and regional Limited Partners interested in increasing their resource allocation to the asset class. AVCA will continue to produce a series of industry publications (such as an African Investment Scorecard similar to that produced for Latin America), newsletters and web-based seminars as an information sharing forum.

Best practice & advocacy

AVCA aims to become the industry's recognized spokesperson stimulating the expansion of the industry and profession in Africa in terms of membership while at the same time providing regulators with concrete proposals for improvement in the corporate, fiscal and legal environment for the industry in Africa and maintaining meaningful interaction with sister emerging market associations. AVCA also seeks to promote and strengthen regional and country associations. The association also aims to become a source of accreditation for members in fundraising mode, collate operational fund management, ethical and business (valuation and corporate social responsibility) guidelines and become the industry standard bearer for benchmarking, reporting and valuation. These efforts should be directed at demonstrating the economic and developmental impact of the industry to regional governments and promoting the case for favorable regulatory (fiscal and legal) policies.

Establishing an industry identity

Much work needs to be done on capacity building for the industry in Africa as most fund managers are groomed and trained in the US or Europe. AVCA already offers its members and stakeholders' high quality training and, capacity building, to uphold high ethical standards of business conduct and professional competence within the industry. Looking ahead, AVCA will devote more effort into targeting stakeholders and governments (particularly in francophone Africa and post conflict countries) to explain the developmental impact of private equity as well as encourage the development of local venture capital associations as a way to foster development of small and medium enterprises.

Networking

Apart from lobbying, AVCA also offers unparalleled access and networking opportunities to members and other practitioners through a well run annual VC/PE Conference. The 8th AVCA Conference held in Gaborone, Botswana attracted some 350 delegates from several countries.

AVCA itself

AVCA's business model, as with other similar organizations, has followed the same route having been funded largely by grants (80%) with the remainder coming from membership fees and proceeds from training initiatives and publications. The objective is to reverse this trend to become self-sustaining. AVCA's challenge, therefore, has been to demonstrate a value proposition worthy of private sector support. The association's board has recently taken steps to achieve this objective through the preparation of a comprehensive business plan to be submitted to two anchor DFIs and some of the larger member GPs for seed funding. In addition, a restructured AVCA (in terms of organization) will as from year-end be permanently based in Nairobi, Kenya.

Future projections

Amid renewed investment interest a number of new trends and developments can be expected over the next couple of years. For one, the upward trend in fundraising is expected to continue despite recent downturns in global markets. Newer sources of funds, such as sovereign wealth funds, are increasing their allocation to private equity.

Second, the upsurge in interest by so-called global limited partners (LPs) has led to the creation of new funds, which are becoming increasingly active in the venture capital and private equity industry in Africa. Finally, several new African-led GPs are expected to emerge on the African scene. ◆

This article first appeared in the September/October edition of *emerging private equity magazine*

In an environment where investors are distressed and looking for liquidity and in which senior debt lenders are applying extreme caution, mezzanine funding is becoming increasingly attractive.

Mezzanine funding now an adVantage

Catalyst caught up with one of the major players in the mezzanine space, Vantage Capital, to find out what makes this form of financing so desirable in the current landscape.

Vantage, a leading black empowerment group, has launched its second mezzanine fund and is expecting commitments of between R2bn to R3bn, according to Managing Partner Luc Albinski, making Vantage Capital the largest mezzanine fund manager in Africa.

Few are better placed to talk about the nuances of mezzanine funding then Albinski who is also a director of Vantage Mezzanine and a member of the Fund's Investment Committee. His primary responsibility is the assessment, structuring, execution and post- transaction monitoring of mezzanine fund investments. He has played a key role in all five investments executed by the Fund to date for a total of almost R980m (US$131m). Albinski established Standard Bank's Mid-Size Private Equity department which focused on executing mezzanine transactions in the mid-market as an alternative to traditional private equity solutions. He co-led several noteworthy transactions as head of Standard Bank's Mezzanine Finance

Mogase

department. These included providing R800m in funding for the buy-out of the South Africa subsidiary of Waco International and providing R1bn in mezzanine funding for the De Beers empowerment transaction.

A classic mezzanine investment consists of a debt or debt-like instrument, paired with an equity "kicker."

A classic mezzanine investment consists of a debt or debt-like instrument, paired with an equity "kicker." The equity component of the investment gives the mezzanine lender upside potential, while the debt component – which generates steady interest payments and ranks senior to the company 's common stock – provides a measure of downside risk protection. The most common formulation is a note which may provide for both current-pay cash interest and pay-in-kind, or PIK, interest, paired with warrants to acquire stock of the borrower. Mezzanine investments can be made using other types of securities as well, such as with preferred stock in place of a debt instrument.

But what makes "mezz" financing so attractive in this bleeding market?

"The simple answer," says Albinski "is that in many cases mezz is the vital "glue" that makes a deal viable. Oftentimes, the amount of senior debt available is just too low to allow for a deal to work for the equity sponsor and a mezz layer is a critical component of the funding mix.

"My experience, particularly since the beginning of 2009, is that the funding taps have dried up completely and many institutions are simply not open for business when it comes to mezzanine lending at the moment.

"Another feature is that mezzanine lenders, typically specialist mezzanine investment funds, offer a competitive rate of return in the late teens to the mid to late twenties.

"Each transaction is carefully examined on its merits and the return the fund seeks is calibrated to the risks we are being asked to take on," explains Albinski. "The amount of equity standing behind us, the strength and predictability of the cashflows, the quality of the security provided to us, the company's position in its industry are all factors that we have to incorporate into this assessment. As a consequence our returns vary quite substantially with lower risk deals generating returns in the late teens while higher risk deals can require returns in the mid to late twenties.

"More than three quarters of our return will typically be earned from cash or PIK interest (or dividend income in the case of preference shares). Ownership interests in the form of equity warrants or other instruments comprise a small portion of our overall return.

"The beauty of mezz is that it can be applied to a broad range of deal structures including ones involving SPVs, preference shares, loans into the target company or into its subsidiaries. So it is difficult to talk about a typical mezz transaction but in the main, mezz will represent about 15% of the total funding mix with equity at 50%+ these days (up from 25-30%) and senior at 35% (down from 50%)."

A broad range of sectors are well suited to this type of funding. Indeed, Albinski says it is possibly more instructive to talk about sectors that are not suited to such funding which would include "highly volatile agricultural product sectors (volatile agricultural commodity prices), junior mining and start technology sectors (negative free cashflows) or low margin commodity trading environments. Most industries with reasonable predictable and sustainable cashflows can be targeted for mezz lending."

And Vantage is looking to take full advantage – if you'll excuse the slight pun – of the current upswing in interest in mezzanine funding.

The launch of its second fund in September 2008 follows the successful investment of Vantage Capital's R1bn first fund in just twelve months.

Mutle Mogase, Vantage Capital's chairman, says the second fund has once again attracted a diverse range of institutional investors. "A number of the institutional investors in the first fund have already indicated that they will participate in our second fund."

Mogase says the Netherlands Development Finance Company (FMO) is planning to provide over R100m for the second fund. In addition Vantage Capital will be raising funds from a number of other European developments banks, private institutional investors and possibly sovereign wealth funds.

"We have received an overwhelming reception to our new fund from both our existing institutional investors as well as potential new partners. The success we have achieved with the first fund, where our involvement was solicited in eight of the ten biggest private equity deals in South Africa last year, has resulted in many investors expressing interest in being involved in the second fund."

In many cases mezz is the vital "glue" that makes a deal viable

Mogase says that based on private equity funds under management in South Africa and in the rest of Africa of over R110bn, the growth potential of mezzanine funds is enormous. "African mezzanine could easily triple or quadruple in size over the next couple years in order to achieve asset penetration ratios that are comparable to more developed markets."

Arthur Arnold, CEO of the FMO, says the company intends to participate in Vantage Capital's second fund based on the successful performance of the first fund.

"Vantage Capital has shown with its first fund that it has the ability to raise finance and also successfully invest the fund. This is a remarkable feature, especially when you consider the short timeframe in which they both raised and then fully invested the fund."

Arnold says he believes Vantage Capital is in a unique position to make a substantial impact on the access to finance with its second fund.

"Our focus is to partner with companies like Vantage Capital to develop innovative mezzanine financing mechanisms for mid-market companies which do not enjoy the same access to finance as that enjoyed by large corporates. We believe Vantage Capital and its team is playing an important role in developing this asset class in both South Africa and the wider African continent."

INTERVIEW

Opportunities exist in every stage of the property cycle – even when the bears have moved in for a period of protracted hibernation. This is the message from Grindrod Bank's small and highly-motivated corporate finance team, which is pursuing some exciting prospects in the property private equity space.

Opportunities for private equity

Shimkins

Catalyst caught up with David Shimkins, head of Grindrod Bank's Advisory Businesses, and Michael Rosholt, who works in Grindrod Bank's private equity division, to find out more.

"The bank was born in 1994 out of the Marriott Group and it was thought at the time that a need for a boutique property merchant bank existed, explains Shimkins. "And at that stage it was focussed on the internal needs of the Marriott Group. Clearly, over time we've had to offer a broader merchant banking package. Our association with Marriott ended about three years ago when Old Mutual made a bid for the Marriott Group.

"Last year, when we were considering the launch of a property private equity fund, property prices were still relatively high and starting to fall on the commercial and retail side but not as dramatically as anything else [in the property sector]," says Shimkins. "And the funding that was being provided by the banks was getting lower, which was creating this massive gap in terms of value where not many property financiers had the capacity to play in. So we saw an opportunity to create an equity fund to cater for that kind of scenario. We were quite fortunate from a timing perspective in anticipating this trend."

Shimkins explains that property investing is an animal entirely different from any other asset class and this is where Grindrod's property expertise comes to the fore: "You can't always efficiently put equity into a property because you don't necessarily get tax deductibility on borrowings related to this equity, so one must try and match the investment with the nature of the revenue streams."

The fund has a flexible investment methodology and is able to make investments in the form of subordinated mezz loans or direct equity as opposed to an 'only

Rosholt

equity' fund. "We took an enormous amount of time putting that infrastructure into place. We wanted to focus on the structure before we canvassed investors," says Shimkins.

Rosholt says that the fund is a pure captive play at present and this speaks volumes for the team's confidence as they're risking their own capital. This also means that they can put their structure to the test before going to market, which they anticipate to be in the next 12 to 18 months.

"We received committed capital from Grindrod Bank at the inception so we could do deals from day one," explains Rosholt.

"During the setup phase we identified many opportunities and have made investments," says Rosholt, "but it became apparent during October last year that the time wasn't optimal to raise capital in the market. Property was being viewed globally as an asset class that was overvalued perhaps and this was feeding into uncertainty in the market."

So Grindrod Bank Private Equity took the decision to continue investing with its internally-sourced seed capital rather than raising funds. "The leverage involved allows us to get large exposure to property with small amounts of our own seed capital. We could do approximately R250m worth of property deals with our current seed capital according to our numbers," says Shimkins.

"You can't always efficiently put equity into a property because you don't necessarily get tax deductibility on borrowings related to this equity, so one must try and match the investment with the nature of the revenue streams."

R25m to R90m is the size of deals where Shimkins believes activity is going to be concentrated in the near-term due to the financial crisis.

"Where we see the opportunities going forward is through distressed selling," reveals Shimkins, "which is rising due to investors' liquidating assets to cover their positions elsewhere. Banks are also not loaning 100 percent loan-to-value as they were. That number is now capped at around 70 percent at the top end so we can help cover that shortfall in funding."

And Grindrod Bank's competitive advantage in this market rests on its holistic approach to structuring property deals. "As Grindrod Bank we can offer the full package; we can do the senior lending, the mezz lending and provide the final amount through equity," concludes Shimkins. ◆

Corporate law firm Bowman Gilfillan's Private Equity and Venture Capital Group (PEVC) has considerable experience in venture capital and private equity transactions, including advising on formation of private equity funds and the underlying investments by such funds.

Reaching out with experience

Wally Horak

The PEVC Group has long standing relationships with some of the world's largest private equity firms, including Kohlberg Kravis Roberts, Denham Capital, International Housing Solutions and AMCI Capital. Locally, Ethos, RMB, Leaf Structured Finance Fund, Chrysalis and Alpha Capital Trust are long-standing private equity clients of the firm.

Horak

The PEVC Group was involved in a number of landmark deals in 2008. Notably, it acted on behalf of Denham Capital, a US private equity firm, in respect of its investment in BioTherm Energy, a South African developer, owner and operator of renewable and clean energy generation projects. The mechanics of the deal involved Denham Capital's acquisition of a controlling stake in BioTherm Energy, providing up to US$150m of equity capital for BioTherm Energy to develop, invest in or acquire projects totalling approximately 300 MW, equivalent to the electricity needed to supply about 500 000 South African households. It also assisted Ethos in the disposal of its interest in the Tsebo Group as well as several smaller deals.

During 2008, the BG PEVC Group provided advisory services to international and local fund managers intending to establish private equity funds in South Africa with most of the funds having a mandate to invest throughout Africa, with specific focus on the energy, resources, infrastructure development and information technology sectors.

A particularly interesting example was the establishment of the South African Workforce Housing Fund SA I (SAWHF) for the International Housing Solutions Group. The SAWHF invests in housing development projects and housing sector companies that primarily serve the approximately five million South African households whose income is too high to qualify for public sector housing programs, but too low to afford most market rate housing. This market segment represents a sizable "missing middle" in the country's housing supply.

The BG PEVC Group also advised First Reserve Corporation/AMCI Capital on its US$1,3bn investment in the Pamodzi Resources Fund, the largest private equity fund in South Africa. It also advised AMCI Capital and First Reserve Corporation on the acquisition by Pamodzi Resources Fund of a controlling interest in a US$420m uranium company comprising Harmony Gold's Uranium and Gold assets on the West Rand; and advised First Reserve Corporation and AMCI Capital in respect of their private equity investments in various privately held mining groups in South Africa.

This experience in Fund formation was also utilised by the Plattner Group, in respect of the establishment of the Plattner Venture Capital Fund, which will invest in South African technology companies.

Through its Africa Group, which has a wide network of correspondent law firms in Africa and which most recently included the establishment of a joint venture in Kenya through an association with Coulson Harney Advocates, Bowman Gilfillan is better placed to offer advisory services that are efficient and commercially sound throughout Africa. In this regard, the firm advised the Pan African Infrastructure Development Fund in its investment in Seawolf Oilfield Services Limited and Seawolf Cayman Limited. The deal value of this transaction is an estimated US$600m. Bowman Gilfillan is currently advising an international private equity investor in the Seawolf Companies in respect of a contribution of approximately US$200 million. ◆

Horak is Head of Tax in Bowman Gilfillan's Cape Town office

While local and foreign investment into growing South African businesses is critical for the stability of the economy, too much outside investment in a company too soon can be detrimental to entrepreneurs.

Finding balance in the venture capital equation: how much is too much?

Julia Long

This is the view of Julia Long, CEO of Here Be Dragons (HBD), the venture capital company set up by Mark Shuttleworth.

Long points out that accepting a big capital investment too early in the business cycle can strip the entrepreneur of a large portion of the equity in his or her own business.

> **"Getting the right investment at the right stage of a business is critical to success."**

"Getting the right investment at the right stage of a business is critical to success," says Long. "The reason for this is that if not enough tangible value can be shown in the early stages, then entrepreneurs generally need to give up a bigger part of the ownership of the business for a smaller investment amount. Whereas if the entrepreneur has used his or her own means to take the business as far as possible, then he or she will be able to have developed more value in the business and ask a higher investment amount for a smaller stake.

"By way of tangible example, an idea is difficult to quantify but value can more easily be attributed to a patented idea. One could get funding at this stage, or the entrepreneur could go on and develop a prototype and perhaps even acquire an initial customer to add further value before seeking funding.

"Once the business is sufficiently built up, venture capital has an important role to play in the SA economy," says Long. "Without it, small business would stay small forever."

Long's advice to SA's entrepreneurs is to build slowly, learning along the way, and to let their own funding take them as far as it can. Thereafter they should look at the various funding options available to them and pick the appropriate funding for the business stage, size and desired speed of growth.

To understand the importance of all these stages, Long explains the steps in the business cycle:

The idea

The entrepreneur is always the first investor, usually investing both his time and a little money in birthing the idea and getting it off the ground. This stage should be funded from an entrepreneur's savings or by additional part time work.

Research

It is worth spending as much time as possible on research. Entrepreneurs should go onto the internet, and talk to as many people as possible about the idea. One need not spend an enormous amount of money on research, and people are usually happy to give their opinion. The more research that is done in early stages the more stable the later stages of a business will be. One can never test the market too well, and this process is also important to affirm that an idea is solid. Long advises not to go for too much funding to soon, just what is required to get the business through the next few months. This stage of the business typically costs in the thousands or tens of thousands of rands and is often funded by friends or family.

Taking the idea to the next level

This stage usually requires a little money to build a prototype, patent an idea, develop the business concept further, and grow a team of competent people to take the idea forward. For this stage, one would typically look at what is called an angel investor – someone with excess cash – or, alternatively, this may be the time to bring some partners on board. Partners should be able to add value, by contributing skills that are complementary to those of the entrepreneur. Investment at this stage may not only be in the form of money – perhaps a skilled friend can help with a patent, or contribute IT or accounting skills. The trick is not to try and do it all alone. Typically, the amount of investment at this stage can be in the hundred thousands and possibly a million or two.

Venture capital: By this stage, a little red tape has developed, and the value of the idea needs to be quantifiable, supported with structures, and include some formal reporting on activity in order to approach companies for further investment. While there need not be any revenue or profits yet, an investor of this amount of money would need to do some due diligence on the business and would expect some type of prototype and sometimes initial revenue. This is often the venture capital market or loan funding stage, with investment being from millions to generally in the lower tens of millions.

Later stage investment: Once a business starts to generate profits, the options change. An entrepreneur at this stage could get financing from the bank, so debt becomes a viable option versus equity. And then later, if more than around R50m is required, private equity could be a good option – whether through acquisition, management buyout or a private equity deal. For this later stage investment, a business would certainly need a sustained revenue stream and have a track record of profitability.

Long

Long concludes that one of the riskiest of these stages is the venture capital stage, which is most lacking in South Africa, despite the fact that venture capital is crucial in getting a business off the ground and to a size that is big enough to attract foreign and local investment. ◆

Long is CEO of HBD

International round-up

Reuters reports that private equity deal volume sank to a five-year low in 2008, one of the industry's roughest years ever, and 2009 is unlikely to get any easier as firms struggle to find deals, keep portfolio companies above water, and pacify increasingly restless investors.

Global private equity activity sank to $188,7bn this year, down 72 percent from 2007, *Thomson Reuters* data show, as the global financial crisis crippled banks' ability to lend for deals.

Buyout deals were just 7% of total M&A volume – the lowest level since 2001 and a far cry from the boom years of 2005-2007 when giants such as Kohlberg Kravis Roberts & Co, Carlyle Group and Blackstone Group were striking multibillion-dollar deals on a regular basis

The *Financial Times* reports that, for Philip Davidson, head of European restructuring at KPMG, the speed with which recession has hit Britain reminds him of "Looney Tunes" cartoon characters like Road Runner and Wile E. Coyote.

"A year after we started to hear about the credit crunch, the economy ran off the edge of a cliff," he told the *Times*. "But like the Road Runner we kept on going, with the legs still spinning. But then in September we started to plunge towards the ground.

"That's different from the past recession and it's taken a lot of people by surprise."

One of the groups caught out is private equity. The lack of availability of debt financing has not only made it difficult for private equity funds to put new deals together, it has also made it tougher for the companies in private equity portfolios to deliver targeted returns.

TheDeal.com has some fun with several notable private equity deals from 2008. The Tin Cup Award goes to Cerberus Capital Management: While the CEO of Chrysler sought a bailout, GMAC tried to turn itself into a bank to get TARP funds. The "E" for Effort Award goes to Apollo-controlled Hexion Specialty Chemicals "for signing a $10,5 billion pact to buy Huntsman, then trying it best to cancel it." The Miscalculations and Misunderestimations Award goes to TPG Capital, for shelling out $1,35 billion to bail out Washington Mutual. The Most Slippery Deal Award goes to BCE. Initially, it was announced as the largest ever, but it just kept on slipping until it was cancelled. The Feel Good Award goes to Kirtland Capital Partners "for successfully executing one of the year's solid exits, by selling to a SPAC." ◆

SOUTH AFRICA PRIVATE EQUITY DEALS 2008

NATURE	PARTIES	ASSET	ADVISORS	VALUE	DATE
Acquisition by	Medu Capital	25.7% of Elite Truck Hire		not disclosed	Jan 29
Acquisition by	Absa Capital from Ethos Private Equity	49,95% stake in Tsebo Outsourcing	KPMG Corporate Finance	not disclosed	Jan 29
Acquisition by	RMB Corvest and Safika Investments	49% stake in Micors Fidelio		not disclosed	Jan 30
Acquisition by	Brait	20% equity in Primedia		R840m	Feb 18
Acquisition by	Medu Capital	41,3% of Copper Tubing Africa	iCapital; Webber Wentzel; Fluxmans Attorneys	not disclosed	Feb 28
Acquisition by	Aureos Capital	30,4% of Sandbox		not disclosed	Mar 12
Acquisition by	African Global Capital from Uranium One	152 000 000 Aflease Gold shares (29,04%)		$40m	Apr 4
Acquisition by	Medu Capital	10% of E'nl		not disclosed	Apr 9
Acquisition by	Lereko Metier Capital Growth Fund from Black Star Investors	a further 10,1% stake in York Timber Organisation (14,1%)	R201,3m	Apr 17	
Sale by	Ethos Private Equity to BAE Systems	IST Dynamics		not disclosed	Apr 18
Sale by	Aueros Capital and other shareholders to Aspen Pahrmacare	60% stake in Shelys Africa	Investec Bank	not disclosed	May 5
Acquisition by	Nedbank Capital (Nedbank) from Boart Longyear	Mining Capital Equipment	Bowman Gilfillan	R130m	May 20
Acquisition by	Imbewu Capital Partners from Autovest	17.4% stake in Autovest		not disclosed	May 22
Acquisition by	Emerging Capital Partners	stake in Blue Financial Services		$15m	Jun 4
Acquisition by	Pan African Infrastructure Development Fund	20% stake in Seawolf Nigeria and Seawolf Cayman	Bowman Gilfillan	$600m	Jun 22
Acquisition by	Nedbank Capital (Nedbank) from Heaven Group	Sweets from Heaven	Nedbank Capital	not disclosed	Jul 2
Acquisition by	Absa Capital (Absa) from Bouygues Travaux Publics and Bombardier Transportation	8% stake in the Bobela Concession		R56m	Jul 8
Acquisition by	Parchment Trading 72 from Enviroserv minority shareholders	Enviroserv (113 371 208 shares)	Merrill Lynch; Absa Capital; Standard Bank; KPMG Corporate Finance;Investec Bank; Absa Capital; Cliffe Dekker; Roodt; Edward Nathan Sonnenbergs; KPMG; Ernst & Young; KPMG	R1,88bn	Aug 5
Acquisition by	Actis	Alstom SA		R5,2bn	Aug 6
Acquisition by	Sphere Private Equity	32,5% of Target Cranes		not disclosed	Aug 15
Acquisition by	Pallinghurst Resources	effective minority indirect stake in the Pallinghurst Ntsimbintle joint venture, a 9,26% stake in PGM SPV and 7,4% stake in the Magazynskraal transaction	Investec Bank; Pallinghurst Resources; Edward Nathan Sonnenbergs	$2,8m	Aug 21
Acquisition by	Pallinghurst Resources	100% stake in Moepi Group	Investec Bank; Pallinghurst Resources; Edward Nathan Sonnenbergs	$25m	Aug 21
Acquisition by	Pallinghurst Resources	40% stake in Richtrau No 123	Investec Bank; Pallinghurst Resources; Edward Nathan Sonnenbergs	not disclosed	Aug 21
Joint Venture	Pallinghurst Resources and Bakgatla	PGM SPV (49,9%:50,1%)	Investec Bank; Pallinghurst Resources; Edward Nathan Sonnenbergs; Cliffe Dekker	R2bn	Aug 21
Acquisition by	Ethos Private Equity	Stake in CQS Technology		not disclosed	Sep 2
Acquisition by (Failed)	Pala Investments from Rockwell Diamonds minority shareholders	all shares not already held in Rockwell Diamonds	RBC Capital Markets;Sasfin Capital; Bowman Gilfillan; Brink Cohen Le Roux; Falcon; Stikeman Elliott; McCarthy Tetrault	to be advised	Sep 10
Acquisition by	Absa Capital (Absa) from Community Investment Ventures (7%) and Venfin (3%)	10% stake in Dark Fibre		not disclosed	Sep 11
Acquisition by (Failed)	Gemfields Resources (Pallinghurst Resources) from Tanzanite One minority shareholders	100% stake in Tanzanite One	Investec Bank	£33m	Sep 12
Acquisition by	Old Mutual Life Assurance Company (Old Mutual) and Capitalworks Private Equity	20% stake in Reclamation	Werksmans	not disclosed	Sep 22
Acquisition by	Pallinghurst Resources	additional stake of 7,61% in Fabergé		$15m	Sep 26
Acquisition by	Capital Alliance Private Equity from Avusa	Nigerian interests	Nedbank Capital; Brink Cohen Le Roux	$3,79m	Oct 15
Acquisition by	Brait IV Investments LPand Brait IV SA Partnership (Brait SA) from Buildmax	14,8% stake (1 333 333 333 shares) in Buildmax	Java Capital; Read Hope Phillips; Webber Wentzel	R200m	Oct 31
Acquisition by	European Islamic Investment Bank	increased shareholding from 9,37% to 26,7%	Investec Bank	not disclosed	Nov 13
Acquisition by	Brait IV Investments LPand Brait IV SA Partnership (Brait SA) from major shareholders in Buildmax	120 200 000 shares in Buildmax	Java Capital; Read Hope Phillips; Webber Wentzel	R132,2m	Nov 20
Acquisition by	A consortium of private equity investors led by Absa Capital Private Equity (Absa) from Kwikspace Modular Buildings shareholders and management	Kwikspace Modular Buildings	Rand Merchant Bank; Investec Bank; Deloitte; JPMorgan; Prinsloo, Tindle & Andropoulos; Cliffe Dekker Hofmeyr; Werksmans; Ernst & Young	R478,2m	Nov 21
Acquisition by	Nedbank Capital (Nedbank), Medu Capital and management from United Foundries	South African Roll Company	Nedbank Capital; Webber Wentzel	R300m	Nov 27
Acquisition by	Capricorn Capital Partners	71.5% of Profibre Products	PricewaterhouseCoopers Corporate Finance	not publicly disclosed	Dec
Acquisition by	Pallinghurst Resources from Platmin	69,84% (258,4m shares) stake in Platmin	Investec Bank; Pallinghurst Resources; Resource Finance Advisors; Edward Nathan Sonnenbergs; Torys; Ozannes	$175m	Dec 11