Catalyst

SA's quarterly Private Equity & Venture Capital magazine

Vol 17 No 1
MARCH QUARTER 2020

Private equity self isolates from COVID-19

VC buyers' market emerges from pandemic

Deals not in complete lockdown

FROM THE EDITOR'S DESK

How will the coronavirus pandemic and resultant global economic collapse affect the private equity industry? The only honest answer is that nobody really knows.

As a healthcare crisis, the most recent precedent, the Spanish influenza, is 100 years old and so offers little use to measure its global sweep and impact. As an economic event, it raises many unknowns about how the sudden demand shock and existential dread will affect business activity and consumer behaviour — especially if the lockdown persists for an extended time.

Yet, a close look at the impact of previous economic shocks, such as the 2008 global financial crisis, can provide some clues as to how PE funds and their limited partners (LPs) will behave in a period of rapid contraction.

Polo Leteka, the co-founder and Executive Director of IDF Capital, tells me that it's all about going into triage mode with her portfolio companies now: to assess the damage, capital requirements to weather the storm, operational issues arising from the lockdown, and a path into the risk-adjusted approach of reopening the South African economy.

There will be opportunities for funds with dry powder, which will establish private equity funds among the major predators, as the coronavirus pandemic peels the weak from the herd. Cash flush, and with mandates that already accommodate a two-year additional period with which to return capital to LPs, means that the industry will be ideally positioned.

But the growing sense of frustration at Government's oftentimes incongruent and seemingly irrational approach to opening up sectors like e-commerce, and allowing an appropriate balance between lives and livelihoods, is palpable among dealmakers that I talk to.

Perhaps most concerning of all was an e-mail that I received from a retired High Court judge who tells me that his suspicions – that state capture forces are using this opportunity to regather and mount a concerted fightback against the president – were confirmed when the decision was taken to rescind the proposal in the draft regulations lifting the ban on the sale of tobacco products.

Connect the dots and it doesn't take a forensic expert to see who stands to benefit from the booming black market.

Saddled with debt to create the fiscal wiggle room to fight the pandemic, South Africa can ill afford to be dragged back to the obsidian days of factional infighting in the ruling party, delaying the long-awaited structural reforms required to ignite growth.

The time for the president to act against those in his cabinet who undermine his mission has arrived. ◆

Michael Avery

Contents

Catalyst

Editor: Michael Avery

Sub-editor: Lee Robinson

Design & Layout: Janine Harms, Gleason Design Studio

Catalyst is published by the proprietor Gleason Publications (Pty) Ltd, reg no: 1996/010505/07
from its offices at 30 Tudor Park, 61 Hillcrest Avenue Blairgowrie, Randburg 2194.

Tel: +27 (0)11 886 6446

Gleason Publications

Adapt or die

For many Private Equity Houses, this will be the second major global crisis they have had to steer their portfolio companies through, following so soon after the 2008 global financial crisis (GFC). And considering that events of the magnitude of a global pandemic like COVID-19, an oil price collapse or freezing of global credit markets tend to happen only once in a generation, the experience will stand them in good stead.

Will this shock sustainably change the way that CEOs and investors look at leverage?

John Bellew, Head of the Private Equity Sector Practice at Bowmans, doesn't think so.

"PE depends in part for its returns on the benefits of deleveraging," says Bellew, "and without leveraging, many funds would not be able to purchase the companies they buy – their internal prudential limits would prevent them from making the investments. Post the financial crisis, a lot of PE houses re-looked the extent of leverage (some deals were being done at debt levels of up to 8 x earnings before interest, taxes, depreciation, and amortisation (EBITDA)), and levels of 3.5 to 3 x EBITDA are now more normal. These are sustainable in a normal market. The industry cannot run on the basis of a worst case scenario outcome."

John Bellew

JP Fourie

Genevieve Alberts

JP Fourie, Head of Investor Relations at Metier, believes there will be a more conservative approach in the immediate aftermath, but that it will be short lived.

"We have seen this before," says Fourie, "After the GFC, there was a similar reaction and by mid-2014/15 you had seen the "come back" of higher leverage and covenant light deals, so there will be a re-look but I don't think it will be permanent."

Genevieve Alberts, executive at RMB Corvest, agrees with Fourie that the crisis will lead to a possible short-term reaction.

"Long term, I've no doubt we will mean-revert back to old habits," says Alberts.

"Whilst historical financial and economic crashes have followed different triggers, most have had excessive leverage at their core. There is no doubt that heavily leveraged businesses are hurting disproportionately right now. Unfortunately, in the very near term, most businesses will have to leverage themselves further just to trade out of the current distress, or they will fail. The benefits of not having a heavy debt-service burden going into this global crisis won't be lost on CEOs or their investors, but as the markets recover and grow again, so too will debt appetite."

But, to Bellew's point, Alberts says Corvest has never embraced aggressive gearing in its acquisition structures.

"We apply a modest level of gearing, cognisant that our market is more volatile than most. We tend to invest for the longer term than some of our peers, meaning ours is not simply a deleverage and exit strategy. Investing for the longer term means leaving some debt capacity available to fund future growth and acquisitions."

On the issue of dealmaking once the COVID-19 lockdown dust settles, Bellew believes that private equity firms with dry powder are ideally placed to deploy, a theme that is echoed around the world and is not dissimilar to past crises, where companies that over-geared were bought out at the sort of multiples that end up making vintage years for acquisitive GPs.

"I think that multiples on disposal for assets bought post-crisis may be very favourable, as good companies starved of cash may be available at attractive prices," says Bellew. "However, I still think banks will be prepared to lend. Each case must be looked at on its own merits. Also, I think a number of deals post-crisis will see PE funds injecting equity in order to strengthen existing balance sheets, and either repay bank debt or remedy covenant breaches."

The challenge for investors right now, according to Alberts, is that the immediate future is somewhat opaque and acquisition prices are likely to reflect that heightened risk.

"Good organic growth is a lot less risky than acquisitive growth and is usually rewarded in the offer price," says Alberts. "In the current South African context, organic growth is increasingly hard to find and therefore high growth businesses do justify higher multiples, particularly if the cash conversion supports it.

And that means, in Alberts' opinion, given low organic growth, GPs cannot afford to shun acquisitive growth models and still deliver attractive returns to shareholders.

"We manage the risk by matching acquisitive growth strategies with high-calibre management teams and partners and, as mentioned previously, by applying modest gearing principles."

Alberts believes that while all of this is being added to any due diligence, the hurdle rates should not change materially, given that the market adapts pretty quickly with prices, valuation multiples and debt reduction to compensate for the higher risk taken.

"I think that multiples on disposal for assets bought post-crisis may be very favourable, as good companies starved of cash may be available at attractive prices." John Bellew

In the end, the lower growth and higher risk is compensated by paying reduced valuation, but the result is that net IRRs remain similar for PE houses.

Another important factor to consider is the South African Reserve Bank's response so far, slashing interest rates by 200 basis points, which Alberts believes will also help to improve the equity IRR, given that the cost of the gearing has reduced.

Bellew points to the South African model being driven by fundamentals, rather than leverage, as key to the sector's resilience against these types of economic shocks.

"Unlike in the international market, PE returns in South Africa have historically been driven more by business growth and multiple growth (for example buying at a 3 PE and selling at a 5 PE) and I think that this will continue to be the case," says Bellew. "At this time, a PE house will want to buy a good asset cheaply and grow it vigorously against its competitors, or in a space where many competitors have been wiped out, I can also still see a lot of 'bolt on' deals where a portfolio company snaps up complementary businesses that are cheap, using follow-on investments from their PE owners. These so-called platform plays are a common feature of African PE generally."

That's not to say there won't be any pain.

Alberts says there is little doubt that private equity investors will suffer along with the underlying portfolio investments through this crisis.

"How much and for how long will depend on the extent of Government lockdowns, the stimulus measures introduced to mitigate the pain, and the quality of the investee management teams who will need to find creative solutions to a low growth environment," explains Alberts.

"Portfolios that are well diversified, do not have heavy debt burdens, have access to rand funding, and where investors do not have exit timing pressures, will fare far better," says Alberts. "RMB Corvest possesses these characteristics; being an on-balance sheet funder means that we can exit opportunistically from a well-diversified portfolio (of over 55 investments) which is moderately geared, and being part of the FirstRand group gives us access to funding and a banking network."

Although it is still early days, Alberts reveals that only a handful of Corvest's portfolio companies are requiring bridging finance from shareholders.

"In most instances, their gearing levels going into the pandemic were modest enough that their primary banks are able to bridge the gap, assuming a temporary financial position. To the extent that the lockdown and market continue to be challenging, far more support from shareholders would be required."

Very little has been researched or published about private equity performance through this shock (it's probably too soon), but common sense would dictate that many businesses carried too much debt into this crisis and now need bailouts.

"I think, unfortunately, that for a number of these businesses that have been unable to trade, any debt is too much debt," laments Bellew. "I think we are going to see a lot of restructurings (better businesses are likely to do this privately; weaker businesses may have to resort to business rescue) but I also think that banks are going to be pragmatic and come to the party to save those businesses that are worth saving. For a bank, it is often better to support a basically healthy company through a crisis than to pull the plug and have to realise security in a fire sale. In some cases, banks will even convert some debt to equity in order to maximise overall."

So what happens next, after the worst pandemic since the 1918 Spanish Flu, and the worst oil shock since the 1973 oil crisis?

"The next step for us and our clients, coming out of this pandemic, is to get back to basics," says Alberts. "Businesses will need to find ways to systematically trade out of the lockdown, preserve jobs and build earnings again. Our role is to support our management teams in this unprecedented climate, and be patient – the returns will return.

The one thing that Alberts says is certain is that there will be business fatalities, and some industry models that will be affected permanently. These businesses will need to adapt to the new normal very quickly – "adapt or die". ◆

EBITDAC

The COVID-19 pandemic has seen a new term coined for business that sums up how the world is changing. EBITDAC = Earnings Before Interest, Taxes, Depreciation, Amortisation and Coronavirus.

Clive Butkow

Catalyst spoke with a couple of doyens in the Venture Capital space – Keet van Zyl, partner and co-founder of Knife Capital and Clive Butkow, CEO of Kalon Venture Partners – to find out how they are managing their portfolio companies through the crisis, and what lessons COVID-19 has dished up so far.

Butkow, who has been in business for 30 years, and involved in building and investing in several tech businesses, says that this is the first time he's ever come across a black swan event that has "changed the playbook."

If you are a high growth, innovation-led technology business looking to raise venture capital, or you have raised venture capital, the one thing that Butkow stresses one must understand is that the market has made a complete 180 degree turn, from being a seller's market to a buyer's market.

"What we are finding, not just in South Africa but all over the world," says Butkow, "is term sheets that have been submitted to entrepreneurs to invest capital in their businesses have been pulled and completely deleted. Term sheets that were going to be signed in a few weeks have now been stretched out to a few months, for the VCs to see what's really happening in the global economy."

"It's been tough, but we have to stay positive," says van Zyl laconically. "Luckily, we have a diversified portfolio, so some of them are actually benefiting – the online education businesses [for example], while others are not."

Van Zyl says that the Knife team is balancing their response between the ability to add value from a knowledge and networks perspective and the funding, which is a bit more complex.

Keet van Zyl

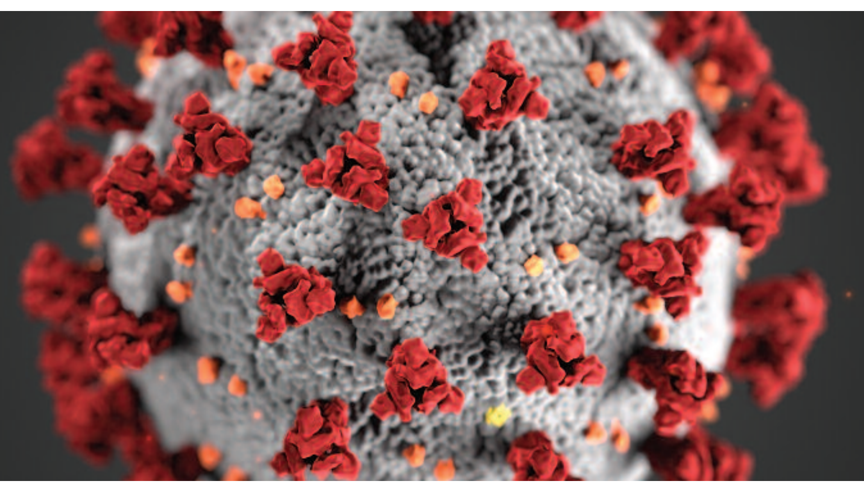
"The VC model is designed around equity instruments" says van Zyl.

But the team have been forced to rethink this approach and innovate due to the extraordinary circumstances created by COVID-19.

"So we have made a portion of our capital available to our portfolio companies, which is basically an equity-type instrument with a tiered return which they can give back to us or not give back to us, so they have a call option to buy us back out or not."

"Effectively, what Knife is doing is saying to their portfolio companies that they've stress-tested, 'here's money'; we are not expecting an IRR in the short-term because our opportunity cost of money, of putting money behind our portfolio in the

" What we are finding, not just in South Africa but all over the world, is term sheets that have been submitted to entrepreneurs to invest capital in their businesses have been pulled and completely deleted. Term sheets that were going to be signed in a few weeks have now been stretched out to a few months for the VCs to see what's really happening in the global economy." Clive Butkow



foreseeable future, is not as much as it would be next year when we actually need it to invest in the next Snapplify, for example."

Butkow points out that a number of different issues are affecting an entrepreneur's ability to raise capital.

"In the venture capital space, business as usual is no more, so my advice to any entrepreneur in the tech space is, if you are a capital lite and capital efficient business, there is still a possibility of raising capital but your chances are a lot lower now than they were before," says Butkow.

"You have to see how much cash you have. Cash is now king, whether you're a one man show or a 50 to 100 man show, cashflow is everything. The key question is, how much runway do you have, and how many months can you survive in the worst case scenario where you've got no more revenue coming in and you have to pay salaries or place people on furlough leave; how much cash do you have to actually survive?"

"The days of just driving topline growth at any cost are over. You have to look at how much that growth is going to cost you now. You've got to become a lot more disciplined in your approach to building a business. So what we've done with our businesses is we've asked them for a normal plan, best case plan and a worst case plan, which must be at minimum, 24 months of runway. The capital markets have dried up."

We all know that the world is going to look different and van Zyl reveals that they challenged their portfolio companies to provide Knife with an action plan.

"What are your immediate actions, what are you cutting? How are you preserving cash? How are you protecting your revenue streams? How are you communicating with your clients and stakeholders? What is your leadership plan."

Van Zyl says that he advised his portfolio companies to use this experience as an opportunity to redefine the business model and actually go onto the offence.

"You can't save yourself into prosperity. If you are a high growth start up, you actually have to have a beyond-COVID plan that looks different to what your business plan looked like before COVID," says van Zyl passionately. "And only when we approve that little plan, which doesn't have to be extensive, then we will make the plug-in capital available."

And if you haven't got that sort of capital runway, then Butkow advises aggressive cost-cutting, using his mantra, "every rand saved is easier than a rand raised". ◆

A crisis to awaken the sleeping giants?

In Viktor Frankl's bestselling book, Man's Search for Meaning, in which he relays how he managed to survive Auschwitz – the brutal Nazi concentration camp – against all odds, one finds the seeds that, if planted in South Africa, might provide the green shoots of our economic and societal recovery.

"In times of crisis, people reach for meaning. Meaning is strength. Our survival may depend on our seeking and finding it."

Following so closely on the heels of the lost Zuma decade of state capture, pillage and political plunder, South Africa is facing the triple threats of a social-humanitarian, economic and fiscal crisis the likes of which we have never encountered. As Ricardo Hausmann quipped in a presentation to the Centre for Development and Enterprise recently, this is no garden variety crisis.

As the country looks to create some fiscal headroom to tackle the coronavirus pandemic, and to cushion the impact on businesses and households in the face of mass closure and retrenchments (Business Unity SA estimates at least 1 million jobs are on the line), with regards to the role of institutional capital like pension funds – amid poor returns locally – forging a response is key.

John Oliphant – former head of the largest pension fund on the African continent, SA's Government Employee Pension Fund (GEPF), current chair of specialist asset management group Third Way Investment Partners, All Weather Capital and JSE-listed healthcare investment company, RH Bophelo – has unique insights into how we should be thinking about mobilising pension funds at this time.

Catalyst caught up with Oliphant at his new Sandton HQ, which is sandwiched between the two glistening new HQs of the JSE's most talked-about corporate concerns, Sasol and Discovery.

We took a seat in the corner of Oliphant's spacious ninth-floor office, with glassed panoramic views of what is increasingly empty Sandton office space. Hard times out on the street seem far enough away.

"I don't envy the president," says Oliphant frankly. "He's got a tough job, but I agree with you that his leadership style is more consensus-seeking, and my wish is for him to make decisions quickly and get us moving. I always say to people that what can create paralysis is not making decisions, and trying to consult with everyone. We need to just get going. There are many things that have been announced and we are starting to see progress on them – we just need to accelerate. He must know that he's got a mandate. We voted, he's in the office now, he must just make decisions; let's get going."

Oliphant comes from a poor background and his journey is one that holds many lessons for the sort of interventions required to catalyse the latent human capital so often singled out by the World Bank and others as a significant structural constraint to growth.

Oliphant graduated as an actuary, one of the most demanding degrees academically, despite the pass rate in his matric year being a staggering 29%, which provides a glimpse into the size of the mountain he had to overcome in terms of access and quality of teaching, and all of those historical issues we are trying to deal with as a country.

"I went to a township school in Tumahole in Parys (the home town of one Stompie Sepei) and I didn't even know what actuarial science was," says Oliphant. "I was the first person in my township to be in the top 100 of the Free State. My mother and father invested a lot in me. My mother always said to me that the only way out is education. Let alone entrepreneurship, we can talk about that later."

Interestingly, Oliphant credits much of his early academic success to Professor William Smith who was awarded the Order of the Baobab (silver) in recognition of his services to teaching and the "demystification of mathematics and science".

"I'm a beneficiary of his wisdom. I used not to go to school and rather sit at home and watch him on SABC, and that's how I learnt my maths and physics. I would then go to school and teach my classmates. My mother knew that irrespective of whatever little money she had, she needed to allocate R2 to me every Friday so that I could go and buy the Sowetan which had supplements from the learning channel, and that was my study guide. One week I would solve problems, and the next week I would buy the paper and mark myself and see the progress that I was making. And that is how I learnt."

It's an experience not lost on Oliphant as we look to improve the country's dismal basic education outcomes.

"I feel that, considering where technology is today, we are not really taking advantage of talented people within the economy to teach much bigger classes. The SABC was my teacher."

High among Oliphant's accomplishments as head of the GEPF was not to get a special mention at the Zondo Commission. The cancer of corruption, which has snowballed since 2007, has eroded the ethical foundations of society, and business has been ensnared by the system's rules, which were established by the politics. BEE lends itself to the creation of a layer of middlemen, for example. With these business challenges, how does someone in his position of influence remain ethical?

"Ethical leadership and morals must always be at the centre of what you want to achieve."

Touching on Frankl's maxim, Oliphant credits his ability to remain moored to his values and principles to his sense of higher purpose.

"If you look at how I ended up at the GEPF, I wanted to make a difference. At the time, I was young and doing well in the private sector as the head of the quant franchise at Stanlib, which had more than R20bn in that proposition. I was 25 at the time, and was head hunted. I remember saying to my mother that I was going to the GEPF and was going to sacrifice my bonuses and salary, but I felt like it was the right thing to do because it felt like an opportunity to make a difference."

John Oliphant

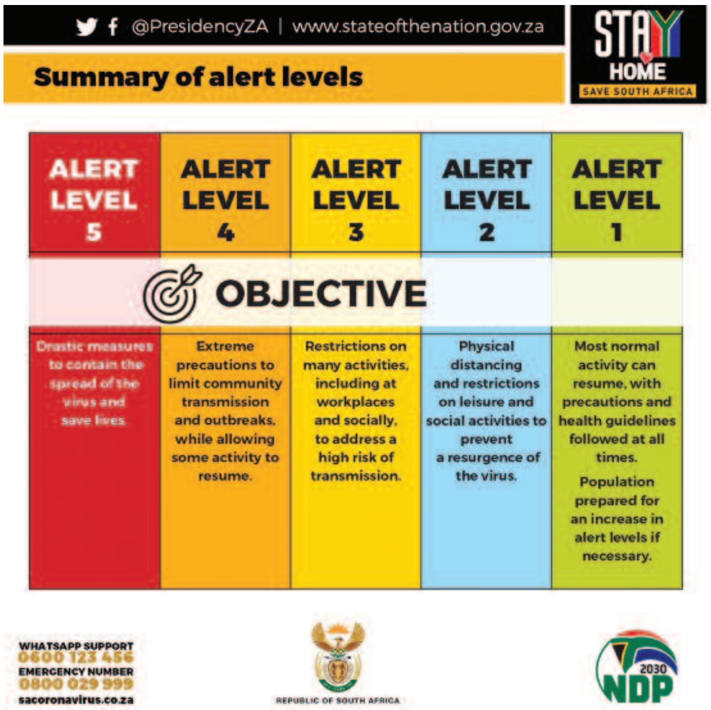
"I don't envy the president. He's got a tough job, but I agree with you that his leadership style is more consensus-seeking and my wish is for him to make decisions quickly and get us moving." John Oliphant

Oliphant was extremely young; 26 when he was appointed head of investments and, at 29, the youngest head of the GEPF. But he ascribes the experience as an opportunity to see life through a different lens. That motivated him to do a Masters in Economic Policy through the University of London.

"I was starting to see the bigger picture: from a quants background of building models and understanding retirement funds, to understanding what retirement funds can do to transform society. I believe that what we need to see more of in South Africa is a servant-type leadership style. The reality is that there will always be bad apples, but I think we have a lot of talented people in our country who can add a lot of value."

And ultimately, it's about harnessing that talent to rebuild the country, which is also where pension funds come into play.

"We need to look at the pot of capital that we have in South Africa, which is worker capital. I've always said that workers need to wake up and see themselves as partners in the economy, and not just as employees. If you look at the pot of capital that they have – there are estimates as to whether this is R6 trillion or R8 trillion – but whatever the number, we need to



look at regulation 28, which regulates savings, and ask if it is fit for purpose, and my view is that it's not.

"If you are saying that roughly 60% of portfolios are sitting in listed equities, and you look at listed equities and who the big players are, it is predominantly Naspers, which is roughly 20% of the benchmark. What are the big assets in Naspers? Tencent, which is in China. So, we need to start thinking about an allocation of capital in our economy and make sure that the actual allocation of capital is used to stimulate the domestic economy. In the bigger scheme of things, we are not allocating capital efficiently."

Oliphant believes that pension funds haven't explored the opportunities because there wasn't a need to search hard for returns. The current environment, as difficult as it is, is actually creating opportunities for alternatives.

Oliphant has been hard at work at Third Way trying to create these opportunities for pension funds to invest in.

One of them is the Third Way Infrastructure Fund which has raised roughly R2,5bn, of which R1,2bn has been deployed in infrastructure projects generating CPI plus 4 and 5% returns in this difficult environment, which is exciting.

"We've created a health care platform called RH Bophelo, which is trying to solve the issue of access to healthcare."

It's a hotly debated theme in South Africa with many health experts questioning the funding mechanism for the National Health Insurance, especially against the backdrop of COVID-19's demands on the fiscus.

"We see it as an opportunity," says Oliphant. "I know people have been talking about the NHI (criticising it) but we see it as a real opportunity. I know, as a father, that every time I pay my medical aid, within three months I've run out of funds in my medical savings and the question is, why? Because healthcare has become so expensive. If you look at how much we spend, in terms of percentage of GDP on healthcare, we spend 10% of our GDP on healthcare – 5% from government and 5% from the private sector – and the private sector services 20% of the population, while the public sector services 80% of the population. And the 10% that we allocate of our GDP is in line with OECD standards. So the issue is not that we are not allocating enough money, but that we are not getting the efficiencies. The RH Bophelo story is about asking how we get into the real economy and make healthcare affordable".

The conversation swings towards student accommodation and, again, there are real opportunities in the economy for pension funds to generate returns.

And the on-balance sheet funding model for infrastructure that government and state-owned enterprises such as Eskom and Transnet have used for the past 25 years has run its course.

"Now that model has come to the end of the road in my view. Because what has happened is that state-owned enterprises have become inefficient allocators of capital and investors are saying, 'now, why don't we go towards a public private partnership-type model?' and that has been demonstrated successfully in the renewable energy space. I know there has been a lot of political debate around whether you need renewable energy and so on, and I don't want to venture into that [debate], but the reality is that the actual model itself is the correct model for funding because then you bring the private sector in to participate."

Oliphant calls it pension public private partnerships (PPPPs)

"I've added the fourth P. We want the pension fund community to become a strategic partner. It's ordinary people. I think that what we need to decide on now is the framework. Either we are going to build, own and operate, and transfer later on, or something else, but that model is what will catalyse pension funds into these opportunities across water, transport, all forms of infrastructure."

Which sounds good, but how do we solve the Eskom crisis?

"Let's look at the impact of load shedding. The economy has now slipped into recession. If you are a pension fund and you work on Reg 28, you can have 40% of your assets outside of SA (30% outside Africa, maybe 10% inside Africa), which means 60% of a typical pension fund's assets are in invested in SA. If the South African economy is not growing, and you've got 60% of your allocation delivering negative returns, it means that workers are going to retire poorer – they might argue that they are poor now, but they will retire poorer. That's why I think we need to find a solution to Eskom, to ensure that we are able to supply energy to the economy and sustain growth; it's in everyone's interest to find a solution. We need to awaken the sleeping giant of worker capital to help find a solution to Eskom. Pension funds must take their responsibility much more seriously."

With much debate around the spectre of prescribed assets, one hopes that South Africa's policymakers settle on this third way of harnessing private savings by ensuring that there are enough bankable and investable projects out there, from clinics, to roads, to railways. This shouldn't be out of reach as the country looks to rebuild after COVID-19. ◆

COVID-19: Takeaways for the private equity industry

Nicole Paige, Michael Denenga, Ashford Nyatsumba

South Africa started 2020 on the ropes, with economists generally expecting the annual GDP growth to be below 1%. This already weak outlook has been exacerbated by the impact of the novel coronavirus (COVID-19) and the consequent curtailment of economic activity. COVID-19 is a game changer, with significant ramifications for every aspect of the global economy, and will bring challenges for the private equity industry.

Fund managers need to be proactive and innovative in coming up with solutions to minimise the impact of COVID-19 on their own operations, as well as those of their investments. The COVID-19 pandemic will disrupt work processes in unprecedented ways.

Funds in the marketing cycle

Nicole Paige

The pandemic will be tough on fund managers in a capital-raising cycle. We are already seeing investors delaying or reducing commitments as they try to assess the impact of the economic fallout on their own balance sheets. Fund managers must be prepared to address these concerns, to redirect attention to the long-term nature of their investments, and to investment opportunities that will ultimately arise from the crisis.

Of course, fund managers will not be able to meet with prospective investors in person for the next few months, or traverse the conference circuit for new sources of capital. While it is not ideal to conduct these discussions without the usual social interaction, fund managers need to adapt quickly. It is an opportunity to leverage a captive audience (quite literally) and fund managers can stay in touch with prospective investors with interactive discussions and topics of interest. It may not be possible to get a firm commitment during the global lockdowns, but it is possible to impress prospective investors with insights and foresight, and to be ready to capitalise on opportunities as soon as the restrictions lift.

Where commitments are already in progress, much of the investor due diligence process can be addressed by making documents and information available in virtual data rooms and through video facilities, so that commitments can be advanced, subject only to the in-person due diligence being completed.

Michael Denenga

Ashford Nyatsumba

Fund managers should not lose sight of new potential opportunities. Impact investing has already started to play a bigger role in Africa as foreign development finance institutions dedicate more funding towards it, and commercial investors appreciate that the impact nature of the investments need not detract from profitability. According to the Africa Impact Report 2019, impact investing has, to date, been focused on energy and financial services. In the aftermath of COVID-19, however, we expect funding to increase in the healthcare, pharmaceutical, urban development and technology sectors.

> "We are already seeing investors delaying or reducing commitments as they try assessing the impact of the economic fallout on their own balance sheets"

Funds in the acquisition cycle

For fund managers in the investment cycle, there is a significant opportunity to capitalise on the market instability and lower valuations, for example, by acquiring listed companies that they may look to take private. Fund financing is likely to be attractive as interest rates are low.

While there are certainly operational challenges in relation to obtaining the required regulatory approvals, and to establishing the intermediate vehicles necessary to structure investments, this need not prevent deals being done, subject to conditions precedent. The negotiation, documentation and electronic due diligence of investments can and should continue to the extent possible. We expect substantial movement in pricing and terms, even as deals are being finalised, so fund managers should be alert and quick to respond.

Fund managers should ensure that their fund documents allow them to complete deals that are in-process after the end of their commitment periods and, depending on where they are in the cycle, should consider requesting a six-month (or longer) extension to the commitment period now, in order to alleviate pressure down the line.

They may also want to revisit their investment guidelines in order to hone in on opportunities arising in particular sectors or geographies, or to redirect their focus to sectors that are not as hard hit by the pandemic.

Funds in the value-add cycle

Fund managers need to take proactive steps to assist portfolio companies to survive the COVID-19 onslaught of lockdowns, suspended operations and upended markets. They should be assisting portfolio companies with developing and implementing contingency plans to address workforce considerations, identify and mitigate any potential supply chain disruptions, and ensure business continuity and financial stability.

Boards of portfolio companies should be reviewing *force majeure* terms of material contracts, reviewing insurance policies to assess potential recoveries for business disruption, managing liquidity and complying with *ad-hoc* obligations to notify lenders of possible adverse effects on their financial condition and/or business operations.

Funds nearing the end of their term may seek term extensions to provide portfolio investments with ample time to recover from short-term depreciation in value.

The implications of COVID-19 are changing with each passing week, and fund managers need to be nimble and seize opportunities as they present themselves. Those that are best prepared, and quickest to act decisively to protect the interests of their investors and portfolio companies, will be the ones that emerge strongest from this crisis. ◆

Paige, Denenga and Nyatsumba are Partners in Webber Wentzel's Private Equity Practice

WEBBER WENTZEL
in alliance with > Linklaters

Deals not under complete lockdown

Despite COVID-19 placing most M&A activity into an extended lockdown, some funds are still managing to announce closure on transactions.

Catalyst caught up with Phatisa Deal Principal, Lize Lübbe, to talk about how she sees the current dealmaking environment after Phatisa Food Fund 2 (PFF 2) and a group of co-investors – Norfund, Mbuyu Capital and DEG – announced the acquisition of integrated agricultural solutions provider, Farming and Engineering Services Limited (FES).

"Due to the tough economic climate and uncertainty, the general attractiveness, or at least perceived attractiveness, of opportunities for acquisition might reduce," says Lübbe. "However, there are interesting pockets of opportunity that are emerging during these times, such as investments in essential goods and services (including food security) and new disruptive technologies (including distribution and e-commerce)."

Lübbe also believes that reduced valuations will pose attractive acquisition opportunities – especially of quality companies with quality management – in the right sectors.

The investment in FES is a case in point, where the company's unique position in Malawi's agriculture matches the fund's mandate to seek out high growth firms in the food sector, and this deal will support FES's long term growth strategy, assisting the company to expand its successful business model to neighbouring countries.

FES's roots date back to 1967. It is the single largest investor in Malawi's agricultural equipment industry, and the sole distributor of several well-known and trusted brands including Massey Ferguson, Komatsu, AJ Power and Toyota Forklift. The company provides a wide range of high-tech agricultural solutions, including precision and low-till farming; drone technology for crop analysis and crop protection; irrigation systems, including water management solutions; and contracting services.

AgriLab, an FES initiative, is Malawi's first independent soil- and leaf-testing facility which allows farmers to test, manage and

control their soil, leaf and water quality. This initiative contributes to improved yields and crop quality, increased revenue and reduced input costs.

FES's impact objectives – mechanising African agriculture, ensuring food security, and enhancing farmer profitability – are aligned with the UN Sustainable Development Goals. Located in a region where resources are limited and input costs high, FES has expanded its offering to include a comprehensive range of climate-resilient precision agricultural solutions.

As part of the new owners' expansion strategy, FES is acquiring (subject to normal conditions precedent) the business assets of agricultural equipment supplier BHBW Zambia. On the back of this, AGCO has agreed to award FES the Massey Ferguson and Challenger franchises for Zambia. FES intends to replicate its successful model of equipment dealership with precision contract farming and other agricultural solutions in Zambia.

The consortium bought the FES stake held by Phatisa's inaugural food fund (African Agriculture Fund) while the company's management maintained their shareholding.

Mbuyu Capital is a specialist African private markets investor, managing segregated accounts of co-investments and funds for institutional investors.

Michiel Timmerman, Managing Partner of Mbuyu Capital Partners, reveals that Mbuyu's co-investments are focused on agri-business, non-bank financial services, logistics & distribution, and healthcare, which present attractive opportunities for financial return as well as impact, by creating jobs, improved food security, access to finance and greater health and well-being.

"FES is a leader and innovator in bringing precision-farming and agritech to Africa," says Timmerman. "New product development and expansion in the region can be expected to benefit the company's growth, as well as its customers – including smallholder farmers – by increasing yields, optimising use of inputs and improving climate resilience.'

At this time of economic stress, debt levels are coming under increasing scrutiny and Lübbe acknowledges that while the leverage model is popular, it is not one that enjoys much success in Africa.

"At Phatisa, we do not believe in high gearing ratios in our portfolio, especially considering the developing status of the economies that we invest in, and a focus on growth investments. As a result, we take a very conservative approach to gearing, and fund growth opportunities through a combination of debt and equity," adds Lübbe.

That's not to say that debt stress isn't emerging. Lübbe is observing a significant increase in debt restructuring across the board, and banks are being forced to exercise patience.

Lize Lübbe

"Generally, valuations will be negatively affected, and some industries might bounce back sooner than others. The average holding period for investments may be extended. We also hope to see a bit more activity in the availability of soft funding, especially for companies in essential goods and services, including those involved in food security and healthcare. It is very likely that PE firms will have to assist companies with further equity, especially in industries that are hit the hardest, such as tourism and hospitality. This might lead to further capital calls to the fund investors. We have generally found that the industry as a whole, and in Africa's case in particular, supported by a very constructive approach by DFIs, has come together with support to get through this crisis."

"Lübbe is observing a significant increase in debt restructuring across the board, and banks are being forced to exercise patience."

One thing is certain, and that is that the industry will forever speak in terms that mark this as a seminal turning point: pre COVID-19 and post COVID-19. ◆

Local news

Exits

Vantage Capital, Africa's largest mezzanine debt fund manager, announced that it has fully exited its investment in Vumatel, the largest fibre-to-the-home network provider in South Africa. The company was established in October 2014 by Niel Schoeman and Johan Pretorius, industry veterans who had previously started up the Birchman Group and Conduct Telecom.

At the time of Vantage's investment in 2016, Vumatel had deployed its open-access fibre optic network across fourteen suburbs in Johannesburg – passing 16,000 homes – and had secured around 4,000 subscribers. It had also received an equity investment from Investec Equity Partners.

Last year, CIVH – majority-owned by Remgro – acquired full ownership of Vumatel after initially securing a 34.9% stake in 2018. Vantage's investors were beneficiaries of this transaction from both ends as Vantage had, in a separate transaction, provided New GX (a black-owned and controlled investor) with mezzanine funding to part-finance their fibre-related assets, including local manufacturing capacity.

Vantage exited the New GX transaction in 2018 and in early May 2020, Vantage's mezzanine facility was refinanced by Vumatel after it secured substantial funding from a consortium of South African banks.

To date, Vantage has successfully exited twelve investments across its three generations of mezzanine debt funds, generating cumulative proceeds of R4.2bn ($360m) and x-money of 2.3x (1.8x in dollars). ◆

Fundraising

Bloomberg reports that Capitalworks Investment Partners plans to invest R5bn of newly raised cash in mid-sized SA companies hit by a shrinking local economy and the coronavirus pandemic.

The firm raised 25% more than planned for its Private Equity Fund III from Morgan Stanley's Alternative Investments Partners unit, institutional investors and wealthy families, Capitalworks founder Chad Smart told Bloomberg. The company is seeking businesses with enterprise values from R250m - R4bn in industries such as financial services, food, and health.

"There are high-quality businesses that are unduly punished by the virus that would usually use a crisis to gain market share," he said in an interview. "With the coronavirus, a number of them don't have turnover coming in; it's an unusual situation. The liquidity and growth-capital need means that you can find the best companies to invest in." ◆

PRIVATE EQUITY DEALS Q1 2020 – SOUTH AFRICA

NATURE	PARTIES	ASSET	ADVISERS	ESTIMATED VALUE	DATE
Acquisition by	Kalon Venture Partners	a stake in Sendmarc		undisclosed	Jan 21
Acquisition by	Five Elms Capital	a stake in Skynamo		$30m	Jan 21
Acquisition by	FSD Africa Investments	an additional stake in MFS Africa		$1,2m	Jan 21
Acquisition by	Secha Capital	a stake in Rush Nutrition		undisclosed	Jan 21
Acquisition by	Havaic	a stake in AURA		R6m	Jan 22
Acquisition by	Senatla Capital Investment Management	a stake in Joe Public United	Werksmans	undisclosed	Jan 29
Acquisition by	Techstars, Platform Investment Partners Growth and Platform45	a stake in Howler		undisclosed	Jan 30
Disposal by	Grand Parade Investments to ECP Africa Fund IV LLC	95,36% stake in Burger King (South Africa) and Grand Foods Meat Plant	PSG Capital; Cliffe Dekker Hofmeyr	R697m	Feb 19
Disposal by	Agri-Vie Fund I to Masimong Group	stake in InteliChem		undisclosed	Feb 20
Acquisition by	Africa Renewable Power Fund (African Rainbow Capital Investments)	stake in CrossBoundary Energy (CBE)		$16,5m	Feb 20
Acquisition by	Two Hop Ventures from Paper Plane Ventures	a stake in Centbee	Cliffe Dekker Hofmeyr	undisclosed	Feb 21
Disposal by	Raubex Roads and Earthworks (Raubex) to Acorn Black Investments	Raubex Property Investments	Investec Bank	R383m	Feb 28
Acquisition by	Nedbank Venture Capital (Nedbank)	minority equity interest in Omnisient	Nedbank CIB	R3,3m	Feb 28
Acquisition by	Investec Private Capital and Compass Venture Capital	minority equity interest in Omnisient		undisclosed	Mar 4
Acquisition by	Apis Growth 12 (managed by Apis Partners) from Efficient minorities	all issued shares in Efficient excluding 110 333 872 shares held by certain shareholders	Bravura Capital; Merchantec Capital; Adams & Adams; Cliffe Dekker Hofmeyr; Nodus Capital	R36,42m	Mar 12
Acquisition by	Capitalworks Atlanta (via special purpose vehicles BidCo and InvestCo) from Peregrine minority shareholders	Peregrine (excluding shares held by subsidiaries)	Java Capital; One Capital; Deloitte; Cliffe Dekker Hofmeyr; Werksmans; KPMG	R4,2bn	Mar 13
Acquisition by	Iron Bridge Capital	investment in Roos Foods (a KFC franchise with 71 stores in several provinces)		undisclosed	Mar 14
Acquisition by	RMB Corvest (RMB Holdings)	investment in Roos Foods (a KFC franchise with 71 stores in several provinces)	Cliffe Dekker Hofmeyr	undisclosed	Mar 14
Acquisition by	Mast Capital and Scott Gibson	a stake in Contactable		undisclosed	Mar 18
Acquisition by	Mainstreet 1754 (Ata Fund III)	a majority stake in Jachris Hose and Couplings	Webber Wentzel	undisclosed	Mar 27
Acquisition by	Growthpoint Properties	stake in Onecart	Eversheds Sutherland (SA)	not publicly disclosed	not announced
Acquisition by	Kingson Capital	a stake in Onecart	Eversheds Sutherlands (SA)	undisclosed	not announced
Acquisition by	Ascension Capital Partners	a 30% stake in CMC SA Investments	White & Case South Africa	undisclosed	not announced