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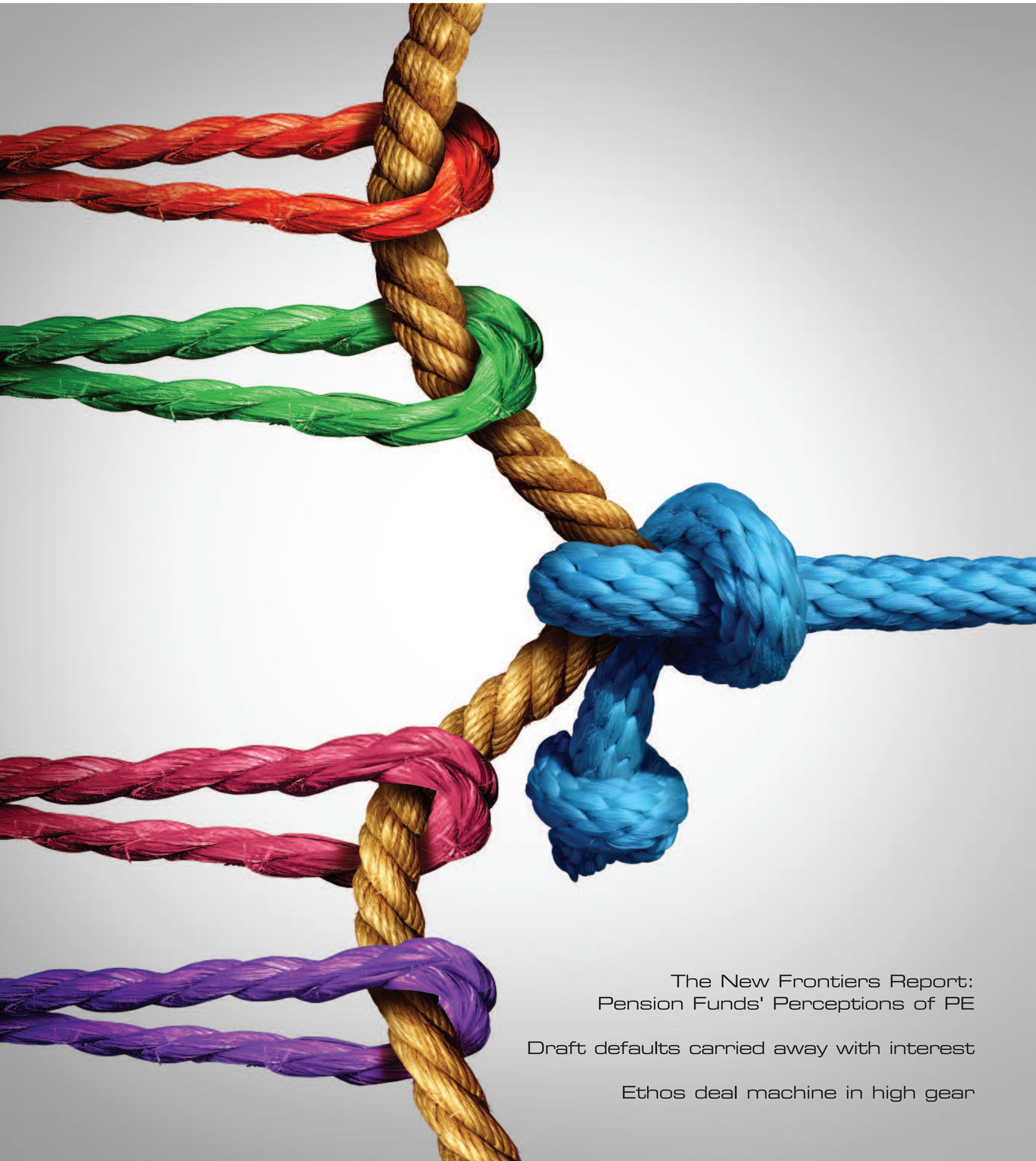

The New Frontiers Report: Pension Funds' Perceptions of PE

Draft defaults carried away with interest

Ethos deal machine in high gear

FROM THE EDITOR'S DESK

Bain's 2016 Private Equity Report makes for illuminating reading.

Hugh H. MacArthur, Bain's Head of Global Private Equity, reckons that the asset class managed to stage something of a surprise rally in the face of what seemed insurmountable odds after the heavy gearing and heady days just before the global financial crisis. He acknowledges that the refinancing of debt and reengineering of capital structures that was behind the turnaround was thanks largely to the Fed and the ECB keeping the cost of capital on the floor and ushering in a period of rising equity markets.

But the GP's still managed to ruthlessly exploit the space. So much so that by last year unbowed LPs relished in a fifth consecutive year when distributions outpaced capital calls, and they responded in kind, substantially upping allocations to the asset class.

MacArthur cites the fact that the past year saw the best environment for fund-raising since the precrash boom. According to Bain, since 2013 PE funds raised $500bn annually worldwide, and uninvested dry powder today stands at a record $1.3tn.

This confluence of factors has been a boon for all but buyers. An avalanche of capital seeking out diminishing opportunity has served to inflate multiples, which might constrain future returns.

The prospect of higher rising interest rates in 2016, coupled with lower growth and more money than ever chasing fewer deal opportunities threatens to become the new normal for now.

According to the most recent data, PE's 10-year returns to large public pension funds outpaced the S&P 500 by 3.7% net of fees. And as the legacy effects of the financial crisis retreat further into the past, PE should consistently perform at a level close to or above public equities over one-, three- and five-year time horizons — as buyout funds are currently doing in all major regions of the world.

This is the theme that is playing itself out here in Southern Africa. The industry is starting to engage in some long-term relationship building with the pension industry to fully leverage allocations allowed under Reg 28 but this has yet to materialise into significant increases to contributions to the asset class. The launch of the report by the Southern African Venture Capital and Private Equity Association (SAVCA) and Batseta (the Council of Retirement Funds), titled *New Frontiers*, on page 1, is an admirable contribution to understanding why attitudes have yet to change materially in favour of private equity.

It is one of the first concrete steps on what will clearly be a long, difficult road to ensuring greater alignment between institutional LPs and GPs in Southern Africa. ◆

Michael Avery

Contents

Catalyst

Editor: Michael Avery

Sub-editor: Gail Schimmel

Design & Layout: Janine Harms, Gleason Design Studio

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Tel: +27 (0)11 886 6446

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Ever since Regulation 28 of the Pension Funds Act was amended in 2011, the private equity industry has been waiting for the floodgates of capital - a maximum of 10% of pension assets under management under the allowed allocation (or roughly R320bn) - but in truth it's been barely a trickle.

New Frontiers, same old problems for pensions & private equity

And a few global trends are starting to exert ever more pressure on pension fund trustees to ensure members are adequately covered come retirement.

One is demographics: quite simply, we're living longer than ever before. According to Dr Amlan Roy of Credit Suisse (the world's demographics guru), high old-age dependency ratios are correlated with greater ageing-related fiscal expenditures by Governments, leading to fiscal pressures and the unsustainability of public finance. This necessitates pension system reforms, due to there being just under four people of working age for every one of pension age, on average, according to the OECD. This trend is not as pronounced yet in South Africa, but appears inevitable.

And the shift towards a defined contribution system in South Africa combined with a period of lower forecasted returns in local and global equity markets simply adds to the pressure to seek out safe and sustainable high-yielding alternatives.

This is why both the pensions and private equity industries are so eager to understand what's driving and shaping attitudes towards the asset class. And why a recently released survey report by the Southern African Venture Capital and Private Equity Association (SAVCA) and Batseta (the Council of Retirement Funds), titled *New Frontiers*, comes as an important first contribution, a yardstick if you will, to measure, monitor and hopefully move those attitudes in the right direction.

Anne-Marie Dálton

The Survey targeted the top 100 pension funds in South Africa and the major pension funds in other SADC (Southern African Development Community) countries. Based on 39 responses, the survey revealed that some 36% of the pension fund respondents have a current allocation or commitment to private equity investments. Of the South African pension funds, 21% increased their private equity allocation subsequent to the regulatory changes that allow South African pension funds the greater allocation to private equity.

Close on two-thirds of respondents indicated that they do not have a mandate nor a current allocation to private equity investments.

Anne-Marie Dálton, CE of Batseta, is mindful of the challenge and determined to help trustees through this paradigm shift as she calls it.

"The paradigm shifts basically started with a shift from a defined benefit to a defined contribution fund to that of being active owners," explains Dálton, "which means there's a different demand on trustees in how they exercise their fiduciary duty. They still need to put the interests of their members first but they also need to ensure that the financial situation of their investments is sound and sustainable. So the whole issue around sustainable investments, responsible investments, is very close to the hearts of trustees in this particular environment."

This move by trustees to act more like owners also highlights the inherent strength of private equity: the ability to play a far more active role in its underlying investee companies, probably far more than one would as a passive pension fund investor into listed equity.

There is also consolidation happening in the pension fund industry and a move towards umbrella funds (an umbrella fund pools the retirement investments of multiple employers, reducing the average cost per member and providing other advantages such as professional governance). Dálton believes this will lead to a reduction in total funds from over 2100 to somewhere around 800.

"But in this particular space it's most likely the top 100 funds that will be participating in private equity," she says. "The other trend that we are witnessing is a move towards greater preservation where provident funds are aligning with pension funds. What that means is that there will be more funds available that will need to be annuitised, two thirds, and that will open up more opportunity for investments into private equity. And all of that plays a role in how the investment policy mandates and statements are crafted going forward."


Erika van der Merwe

CEO of SAVCA, Erika van der Merwe, says that respondents to the survey cite a lack of familiarity with the private equity asset class as one of the primary reasons for not investing in it. This suggests that it is an imperative for the private equity industry to take the lead in providing meaningful and interactive education about the characteristics, workings and benefits of the asset class.

"To raise greater awareness of private equity, the private equity industry has to understand the needs and concerns of the spectrum of stakeholders who play an influential role in the allocation of capital by pension funds," says Van der Merwe. "This spectrum ranges from investment professionals who are dedicated full-time to the task, to employee representatives who serve part-time as trustees, and also to asset consultants who advise funds on various aspects of investment and the administrative process."

"The survey finding of a low number of pension funds taking advantage of the opportunities that private equity offers is consistent with our anecdotal assessment of industry trends," she says.

Pension funds indicating through the survey that they have an allocation to private equity range from large to small – although larger funds are more likely than their smaller counterparts to have a private equity allocation. Of those in the sample that have private equity exposure, 35% have less than R5bn of assets under management, 30% have between R5bn and R35bn of assets under management, and 35% have more than R35bn of assets under management. These funds comprise defined benefit, defined contribution and hybrid funds, and more or less an equal number of pension, provident and standalone funds. But van der Merwe admits that DB (government funds such as Eskom) understand the asset class better than most.

For survey respondents, the most common means of exposure to private equity investment is through a fund-of-funds structure, with either a South African or a broader African mandate. A less prominent route is to invest directly into one or multiple private equity funds.

An analysis of respondents who indicated that they do not have a private equity exposure suggests that smaller pension funds and pension funds which are defined contribution plans, are less likely to opt for private equity. "The top reasons given by this group for not investing in private equity are, firstly, unfamiliarity with the asset class, secondly, the liquidity characteristics of private equity and, thirdly, a lack of internal capabilities at pension fund managers to oversee a private equity programme," says Van der Merwe.

Given its positive attributes, including high-returns potential and portfolio diversification features, Van der Merwe says that the omission of private equity investment by many pension fund managers is a significant missed opportunity, Over the past decade, returns to investors in private equity in South Africa was 20.7%, compared with a return of 14.9% on the JSE All Share Index.

The research also reveals that the majority of the surveyed pension fund managers employ asset consultants for certain support services. "While the level of participation and influence of asset consultants vary considerably according to survey responses, it is evident that the role of advisors to the pensions industry is critical," says Van der Merwe.

So what is BATSETA doing to change attitudes and educate trustees?

"We have already done some work in relation to the integration of ESG into the decision making processes where we have launched a guideline called responsible investment and ownership," explains Dálton, "which gives funds and idea of how they can integrate their decision over a period of about three years, to the extent that by the end of that period they will be active owners and understand the process much better."

"The second issue is assisting with the training and education and here we work with the ASISA academy around training and development, especially when it comes to investment fundamentals. And then also we have just piloted a project where we will train trustees how to become active owners."

The survey is a promising starting point along the road to reforming attitudes, providing a useful yardstick against which all the role-players can now measure progress. It's beyond simply seeking capital for private equity funds. It's about ensuring generations of South Africans can retire in relative comfort and security. The mission, therefore, is critical. ◆

In seeking to reform the South African retirement industry to provide better outcomes for more savers and pensioners, it seems the Treasury is at risk of throwing the baby out with the proverbial bathwater in how it is treating performance fees in its draft default investment portfolios. More specifically, when it comes to the alternative asset classes of private equity and hedge funds.

Alternative view lacking in retirement fund reforms

Catalyst caught up with private equity law doyen, John Bellew, Head of Private Equity at Bowman Gilfillan, to find out why the industry (and DB funds in particular) should be concerned.

In July 2015, National Treasury took the first step towards implementing proposals that aim to lower charges and improve market conduct in the retirement industry. These proposals form part of the broader retirement and savings reforms initiated in 2011. Often referred to as the McCarthy reforms, after being driven by David McCarthy who is no longer involved in the process following the high profile union-induced delays and happily teaching actuarial science at Wits, the proposals are outlined in the document *2014 Budget Update on Retirement Reforms*, published in March 2014. The improvements in market conduct for the retirement industry are also in line with the broader regulatory reforms in financial services such as Treating Customers Fairly and the Retail Distribution Review currently underway, led by the Financial Services Board.

The draft default proposals published for public comment follow from the Treasury paper, *Charges in South African Retirement Funds*, published in July 2013. This paper found that parts of the South African retirement system are characterised by complex and opaque products, with high charges. These factors make it impossible for consumers and employers to exercise choices in a way that leads to the best outcomes for members of retirement funds.

Treasury notes that low rates of preservation and participation in the retirement system, particularly by lower paid workers, exacerbate the problem, leading to higher than necessary costs and charges.

In many cases, Treasury believes that retirement fund members have been automatically enrolled into excessively complex, unreasonably expensive or otherwise inappropriate default investment portfolios. This is part of the reason behind the release of draft default regulations last year.

The draft default regulations were published in terms of section 36(1)(c) of the *Pension Funds Act, No. 24 of 1956*. These regulations, when adopted, will require all retirement funds to operate a set of default policies that are in the long-term interests of members rather than of service providers. The regulations will also prescribe the conditions that such default policies are required to meet.

What role do defaults play in the retirement system?

Default options are automatic choices made on behalf of members who do not exercise their choices in a given situation. There is currently no requirement for funds to provide default options, and, where they exist, current defaults often favour the interests of service providers, often working against the interests of members.

But when the draft default regulations were

published, a few concerns rippled through the alternative asset class industry, especially regarding fees or carried interest as it's known in private equity. Specifically, Reg 37(2)(h) notes that "no service provider (may) receive fees or charges in respect of the assets held in respect of the default investment portfolio that depend on the return earned in respect of those assets…".

The question that arises then is whether carried interest is considered a "performance fee"?

Bellew believes that we first need to examine why the industry has taken to alternative asset classes in the first place.

"In the South African context the experience of investors in private equity has generally been one of excellent returns," says Bellew. "Over a fairly long period private equity has outperformed the stock market. Particularly in a defined benefit environment it makes sense to have exposure to asset classes that provide both diversification and superior performance."

Bellew says much of this change in attitude towards alternative asset classes can be traced back to the introduction of amendments to Regulation 28 of the Pension Funds Act.

"If you go back to the old regulation 28, there was very little encouragement or ability to invest in private equity. When the amended regulation was gazetted in 2011 it allowed pension funds to invest up to 10% of the fund in private equity, 2,5% per PE fund and 5% in a fund of funds. So from a regulatory perspective there has been an acknowledgment that there is real role for private equity and for hedge funds to play in a proper balanced pension plan."

John Bellew

> "Bellew points out that, in South Africa, carried interest is typically structured as a profit share that comes out of the underlying partnership that owns the assets. It is not a fee."

The draft default regulations don't differentiate between the old defined benefit funds (the bulk of those still in existence are in the government sector and have greater demands on their returns profile because benefits, as the name suggest, are predetermined) and the now ubiquitous defined contribution funds.

"The draft regulations provide that you need to have a default investment portfolio that you have to offer to your members and that investment portfolio may not contain assets that attract a performance fee of any nature," says Bellew.

But performance fees, or carried interest, or profit sharing, are at the heart of the remuneration structure in private equity, explains Bellew.

"Private equity is a long term investment and the basic model is that you pay a 2% per annum fee on the amount of capital that is either committed to the PE fund or that is drawn for investment by the fund. In a successful fund you have to give that 2% management fee back to your investors plus a hurdle and once you are through that hurdle the PE manager effectively takes 20% of the profit of the fund as its carried interest."

Bellew points out that in South Africa, carried interest is typically structured as a profit share that comes out of the underlying partnership that owns the assets. It is not a fee.

"In relation to the new draft regulations though, I think the position is unclear because whether investors are paying an asset manager a fee or sharing profit with the PE house, they are giving up returns in favour of the asset manager, based on returns," says Bellew. "Substantively, therefore, there is a risk that for purposes of Regulation 37(2)(h) carried interest is a fee."

"My overriding view is that the whole performance fee debate is perhaps overkill. We already have Reg 28 which says a pension fund may commit 10% of its assets to PE and other alternative investments. It doesn't then make sense to adopt an approach in relation to default investment portfolios that effectively excludes such assets from the default portfolio. You're trying to squeeze too much into a one size fits all box and pensioners are the losers. There just aren't any PE funds out there that don't have a carried interest model of some sort or other, and this is unlikely to change."

The next part of Reg 37(2)(k) says that members "may instruct the fund to transfer their retirement savings from the default investment portfolio into any other investment portfolios….at intervals not exceeding three (3) calendar months…".

"I think if you take a step back and you look at what I think was hoped to be achieved with Reg 28," Bellew says, "was that now that pension funds and hedge funds would have the ability to invest more money into these asset classes that they would in fact do so."

But that hasn't happened.

"So we sit with the same old suspects which tend to be the DB funds where long-term asset matching allows you these long-term illiquid investments in PE funds. If you have to be able to trade every three months, it's going to be a fairly significant barrier to investing in private equity because there just aren't ready markets for interests in these private equity funds."

Internationally, there are secondary markets where you can trade a portion of your interest in a PE fund but they are privately negotiated transactions, and as Bellew points out, they take a long time to consummate and you "suffer a discount as the investor for the liquidity benefit that it offers."

But it's not all doom and gloom for the blossoming relationship between pension funds and private equity. Bellew believes there's an opportunity in all of this for some out-of-the-box solutions.

"There's is a need for some creative thinking between the PE industry and the pension fund industry, to come up with products that allow you exposure to private equity while still giving you liquidity. They do exist in the non-pension space. For example, you can go to certain insurers and you can buy an endowment policy with an investment in private equity. You can effectively exit this investment but you will take a hit on the valuation."

"I can't say that I've heard a lot of noise about it in the market. Perhaps it isn't receiving the sort of attention that it should receive from the PE industry," concludes Bellew.

The period for public comment closes in September and the industry would be ill-advised not to consider some creative proposals to ensure defaults don't erode the gains of the recent past. ◆

Globally, the importance of safety compliance in several high-risk industries is no longer in question. Numerous accident and incident investigations identify the lack of compliance with regulations, rules, and governing procedures as a central contributing factor to accidents and fatalities.

Ethos finds an Eazi margin of safety

In South Africa, the Lily Mine disaster and the Grayston Bridge collapse are recent high profile examples of the inherent safety risks in these two industries. And the drive towards zero-harm is part of the reason that Ethos announced a R1,6bn investment into The Eazi Group, Africa's market leader in the rental, sale and servicing of work-at-height and material handling solutions, including access platforms, telehandlers and accessories.

Ethos Fund VI acquired 65% of the business, with an investment vehicle controlled by Jonathan Beare (Buffet Investments) and founding shareholders owning the remainder.

Founded in 2003, The Eazi Group – comprising Eazi Access Rentals, Eazi Sales & Services, Eazi Africa and other subsidiaries – boasts the largest and most diverse fleet of boom lifts, scissor lifts, telehandlers and vertical personnel lifts on the African continent. The Group services customers across various sectors of economy in the construction, shipping, manufacturing, FMCG, transport, entertainment and mining industries, by offering work-at-height and material handling solutions, including application solutions, machine training, on site project management and support. The Eazi Group has exclusive distribution rights for leading brands in South Africa, including JLG, owned by NYSE-listed Oshkosh Corporation, and considered one of the world's leading mobile high access equipment manufacturers; Magni telescopic handler; and Maeda mini cranes.

Jean du Randt

"Ensuring safety is not always a given in high-risk industries. In South Africa, it is evident that there is a lack of compliance with legislated safety regulations. Safeguarding and protecting employees in the workplace is non-negotiable - no matter what the costs or challenges are," says Jean du Randt, General Manager: Group Services of the Eazi Group.

In the 2014 Health and Safety statistics report for South Africa's mining sector, Minister Ngoako Ramatlhodi, who headed the Department of Minerals and Resources at the time, conveyed his condolences to the families of the 84 mine workers who lost their lives that year. While he commended the reduction in fatalities over the past two decades, the fact

Shaun Zagnoev

remains that mining is still one of the most dangerous occupations in the country, as recently seen in the accident at Lily Mine in Mpumalanga, which dominated the news in the first quarter of 2016.

Despite the dangers inherent in mining, the construction industry has surpassed the mining sector in recorded fatalities. According to the Federated Employer's Mutual Assurance Company, construction-related fatalities average 150 per year, with an additional 400 accidents occurring on average annually.

Former Minister Ramatlhodi also stated that 35% of mining fatalities are related to working at height. This statistic is echoed in the construction sector and is compounded by a lack of fall protection gear and equipment, and undoubtedly a lack of knowledge of safety requirements.

The construction boom in South Africa is rapidly driving up the demand for work-at-height solutions, and also increases the need to conform to safety governing procedures, rules and regulations. Recent changes to economic conditions also drive a need for efficiency, culminating in deployment of improved ways of working at height.

"The trend of deploying more mobile elevated work platforms to perform work-at-height duties more efficiently calls for proper instructions to operate machinery while following safety and compliance regulations. These are the prerequisites for the reduction of fatalities in high risk industries," says Du Randt.

Additionally, all driven machinery is regulated by the National Code of Good Practice and therefore has to comply with this legislation. NCOP 2015 associates mobile elevated work platforms with a C53 license. Du Randt elaborated, "This license is currently based on the MEWP unit standard and, albeit controversial in its construct, delivers a sound basis for operating a MEWP. We found that some training providers incorrectly associate one of the crane unit standards putting the operators and their employers at risk."

This latest transaction is Ethos Fund VI's fifth investment in 12 months, following recent investments into: Eaton Towers – a leading pan-African telecom-towers company; Neopak – which offers world-class paper-based packaging solutions across South Africa; Twinsaver – a leading South African manufacturer, marketer and distributor of branded tissue products; and, Autozone – the largest privately owned automotive parts retailer and wholesaler in Southern Africa.

Brett Fleming

Ethos also announced the realisation of Plumblink to JSE-listed Bidvest in mid-2015, for which it scooped the coveted Catalyst Private Equity Deal of the Year Award for that year; plus the sale of its shareholding in JSE-listed Transaction Capital last December.

Commenting on the investment, Shaun Zagnoev, Ethos partner, said the Eazi Group is a prime example of South African pioneering spirit where visionary entrepreneurs identified a void in the market, and through grit and determination established a new industry.

"In a little over a decade, management built a differentiated business, offering service excellence, enhanced safety and innovative cost-effective solutions to their customers. We are delighted to invest in the next phase of Eazi's journey to reach full potential," says Zagnoev.

Billion rand deals are rarely born and hatched overnight as Brett Fleming, CEO of The Eazi Group reiterates. "Ethos expressed interest in our business over many years, during which time we developed a trusted relationship. When the opportunity presented itself, Ethos – with its value-add capability and experience in partnering owner-managed businesses – was the ideal partner to cultivate our growth strategy."

Ethos is harvesting the years it has spent developing these relationships and realised with the Eazi Group that, sometimes, regulations can actually be good for business. ◆

Black-owned and manged private equity house Medu Capital showed that there's still some deal activity in the medium-sized market with the R450m acquisition of Universal Paints and Elite Truck Hire.

Medu Capital looks to build from the middle

The investments were made through Medu Capital's third private equity fund, Medu III, and will include a management buy-in component.

Universal Paints, founded in 1982 by Tony Ferreira, manufactures and supplies decorative paint and coatings. 16 dedicated factory outlets in Gauteng are the sole suppliers of Universal's products, thereby eliminating the costly middleman and high retail overheads. These savings are passed directly on to its customers, which include homeowners, professional painters and the construction industry.

Elite Truck Hire has provided short and long term truck hire including Full Maintenance Leasing (FML) services to the South African industry for over 25 years. With offices on the East and West Rand, in Midrand and Cape Town, the company is now black owned following the acquisition, and services more than 150 customers with a fleet strength exceeding 1,200 vehicles. The company has expanded into the refrigeration and construction industries with refrigeration equipment and crane trucks now available.

Paul Moeketsi

Two associated businesses include Elite Line Haul which is a heavy, long distance transport operator linking centres throughout the country as well as to destinations in Zimbabwe, Zambia and Mozambique. Elite Forklift Rental offers a comprehensive range of forklift trucks on Full Maintenance Leasing and short term rental.

Nhlanganiso Mkwanazi

Medu Capital invests locally and internationally sourced institutional capital in established medium sized enterprises in South Africa and the rest of Africa. The executive management team invests alongside its investors, and believes in partnering with various owner-managers in growing and developing the portfolio companies.

Medu Capital executive Paul Moeketsi, who was involved in each deal, said that new managing directors have been appointed to each company, both of which have invested alongside Medu Capital. Moeketsi adds that the acquisitions are in line with Medu Capital's strategy of investing in well established businesses with a proven record of success.

"Both Elite and Universal deliver high quality products and services to customers and have experienced and successful management teams. In the case of Elite, we have increased our initial 27% stake acquired in 2007 to 100%, which we believe sends a clear signal of our confidence in the company and its management," he says.

Byron Corcoran, the new managing director of Elite Truck Hire, says he is excited about the opportunity to lead the company, which is a successful business with a strong platform for growth.

"We chose to partner with Medu Capital because of their established track record and significant experience as a private equity investor in partnering owner-managed businesses," he adds.

Nhlanganiso Mkwanazi, Medu Capital co-founder and director, says that Medu Capital is actively seeking portfolio companies in which to invest. "We closed Medu III in 2014 with capital of R1,1bn and this fund still has significant capital to invest. That is great news at a time when confidence and investment in the country is low."

While Medu is typically interested in medium-size businesses, it favours enterprises that are well established, as is the case with Universal Paints and Elite Truck Hire.

"We prefer businesses with sound systems and strong management. We identify opportunities in well-run businesses that have the potential to become bigger: companies that could become corporate entities but require greater depth in terms of their commercial skills, systems or capital. This is where our particular skill set and expertise adds significant value and dovetails with the experience of the management team," concludes Mkwanazi. ◆

The International Private Equity and Venture Capital (IPEV) Valuation Guidelines have been updated and the December 2015 edition has been released.

IPEV Valuation Guidelines 2015 – what's changed?

Heather Carswell

The changes include clarifying edits and technical edits. The main technical edits are in respect of the following topics:

- Use of the Discounted Cash Flow methodology
- The value of debt
- Revenue multiples
- Backtesting
- Non-control investments

Use of the Discounted Cash Flow methodology

The note accompanying the release of the updated Guidelines describes one of the technical clarifications as having "removed the negative bias towards DCF [discounted cash flow]".

The shift in preference for multiples-based valuations over DCF-based valuations has been a gradual evolution over a number of years and a number of editions of the Guidelines:

- October 2006 edition – the Valuer was advised to "be biased towards those methodologies that draw heavily on market-based measures of risk and return" (i.e. multiples-based methodologies) and noted that "Methodologies utilising discounted cashflows and industry benchmarks should rarely be used in isolation of the market-based measures and then only with extreme caution." The October 2006 edition carried on to note that "there is a significant risk [in] utilising this methodology".
- September 2009/August 2010 edition – no change.
- December 2012 edition – the wording discouraging the use of the DCF was somewhat softened and the Guidelines also introduced new wording that "accounting standards do not specify a hierarchy of valuation techniques" but there was still "significant risk in utilising this valuation technique".

While the December 2015 edition of the Guidelines states that the "negative bias" towards the DCF has been removed and the "use of multiple valuation techniques is encouraged", much of the wording remains unchanged:

- According to the updated Guidelines, there is still "a significant risk in utilising this valuation technique"; and
- The DCF is described as a "useful cross-check of values estimated under market based techniques" and still implies that the multiples-based methodologies would be the primary valuation methodology applied.

In all editions, including the most recent, this aversion to the DCF is ascribed to the "substantial subjective judgements" which are required and the "high level of subjectivity".

In highly developed markets, there may be a number of listed companies to choose from which are truly comparable with the company being valued with respect to industry or sector, jurisdiction, size and growth prospects. Where this is the case, giving preference to the use of market multiples may be appropriate.

Carswell

However, in smaller markets, and especially emerging markets, finding a truly comparable listed company in the same jurisdiction can be difficult, if not impossible. As a result, market multiples are typically derived from listed companies in other countries and adjusted for points of difference, of which there are many.

While the DCF is described as requiring a high degree of subjectivity, these adjustments required to the market multiples are often more subjective. By way of example, the difference in country risk can be observed with reference to traded Government bonds and accounted for in the discount rate applied in the DCF. Similarly, reliable information informing the Valuer on the adjustment to make to the market multiple is not available.

Despite the negative bias towards the DCF that persists in the Guidelines, in our view the DCF generally remains a more accurate valuation technique.

The value of debt

An update has been made regarding the value of debt to be deducted in arriving at the value of equity.

Essentially, the question is whether to deduct the face value of debt or the fair value of debt. Where the terms of the debt are significantly more favourable or onerous than those that the company being valued could negotiate on an arms' length basis at the measurement date (on a standalone basis), the fair value may differ from the face value of the debt.

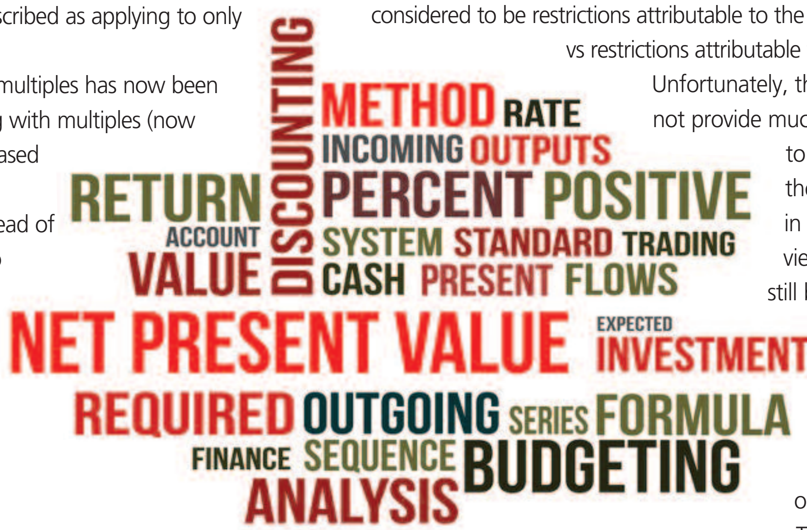
Since the definition of fair value assumes a hypothetical realisation, a hypothetical change of control is assumed as at the measurement date in most cases. Therefore, the treatment of debt is based on what would happen during a change of control. If the debt in question would be repaid in the event of a change of control, the value of debt to be deducted is generally equal to the face value of the debt. Previously, the Guidelines considered whether the debt "must" be repaid (i.e. a requirement to repay) – this has been updated to "would" be repaid (i.e. an expectation of repayment, rather than a requirement).

The guidance on the value of debt has been expanded to give consideration to the treatment of penalties for early payment, for example breakage fees. The Guidelines now allow such penalties to be incorporated into the value of debt based on the probability of them being paid.

Revenue multiples

Revenue multiples have been discussed in previous versions of the Guidelines, but were presented as an industry valuation benchmark technique and described as applying to only limited industries.

The discussion of revenue multiples has now been included in the section dealing with multiples (now both revenue- and earnings-based multiples) with more detailed guidance being provided. Instead of confining revenue multiples to only certain industries, they are now considered to be appropriate for companies which have not yet reached sustainable profits but have established operations.



Backtesting

After having been introduced in the August 2010 edition, the concept of calibration was significantly expanded upon in the December 2012 edition of the Guidelines. The December 2015 edition of the Guidelines have now introduced the concept of "backtesting".

The objective of backtesting is for a valuer to measure his or her most recent valuation against the proceeds actually received on exit, and understand the reasons for points of difference. Such reasons are likely to include new information which became available since the most recent measurement date, changes in the business being valued as well as significant macro-economic changes. The valuer should consider whether the information at hand at the measurement date was properly considered and properly treated in the fair value estimation, given the actual exit price achieved. This process should assist the valuer in refining their approach and/or assumptions in fair value estimates going forward in order to continuously improve the valuation process.

Non-control investments

A new section has been included in the Guidelines to take account of a situation where a minority or non-controlling shareholding is acquired and the interests of the non-controlling shareholders are not aligned with the interests of the controlling shareholders.

While the subject is raised, the guidance essentially reverts to a consideration of how a market participant would view the situation rather than instructing the valuer on how this should be treated.

Other changes

Various other changes have been made to the Guidelines, primarily to clarify wording surrounding existing concepts.

In the South African context, where lock-in discounts for BEE shareholders are common, the reference to contractual restrictions on trading – and whether this allows the valuer to apply a discount to a listed share price – are particularly relevant.

The Guidelines have expanded the wording regarding contractual restrictions to include an examples of what would be considered to be restrictions attributable to the holder of the share vs restrictions attributable to the share itself. Unfortunately, these examples do not provide much additional insight to assist in evaluating the issue of BEE lock-in discounts. In our view, arguments can still be made to support BEE lock-ins as being either a restriction on the share itself or a restriction on the holder.

The Guidelines have seen a significant evolution over the past ten years with welcome additional detailed guidance being provided on how to practically apply the relevant accounting rules to the valuation issues faced in the Private Equity environment. In addition, the introduction of concepts such as calibration and back testing show a desire to continuously improve the valuation process and set a high standard for valuation practitioners. ◆

CARSWELL is a partner T&R Valuation, at KPMG Johannesburg.

Local and International news

National news

Business Day reported that Patrice Motsepe, South Africa's first black billionaire, has launched a new money management firm with two former Sanlam veterans that could become an "influential" investor in Barclays Africa. The official launch of African Rainbow Capital (ARC) represents Motsepe's plan to create a world-class, black-owned financial services giant.

The company's focus will be on financial services and private equity investments, building interests in banking, insurance, distribution, asset management, property, and healthcare administration and management.

Motsepe's company, Ubuntu Botho Investments, partnered with JSE-listed financial services group Sanlam to start the Africa-focused private equity firm.

African Rainbow Capital has a R10bn commitment from Ubuntu-Botho Investments.

The venture is jointly headed by former Sanlam CEO Johan van Zyl and former Sanlam Investments CEO Johan van der Merwe. ◆

The outlook for African hotels and commercial property is robust as we see corporate long stay and tourism increasing and rising with the African tide right now.

Vantage Capital, a specialist PE firm, announced the provision of R80m of debenture funding to United Africa Group, a leading Namibian hospitality and property-owning group.

The funding is being used to support the group's equity contribution for the construction of a new Hilton Garden Inn, a 181-key three-star hotel to be located in the heart of the Windhoek city centre on Freedom Square, adjacent to UAG's existing five-star Hilton Windhoek Hotel. ◆

International

Preqin research for 2015 found that the average proportion of female senior employees at private equity firms is increasing across most geographies and strategies. Overall, women currently constitute an average of 12.6% of senior employees at private equity firms, up from 11.7% in 2015.

Asia-based private equity firms have consistently had the highest average proportion of female senior employees, and this trend has continued in 2016, with 11.9% of senior roles being held by women.

Across other regions, the average proportion of female senior employees has grown slightly, and now stands at a little above 10%. Firms based in the rest of world have seen the biggest increase from 2015 to 2016, as the average proportion of senior female employees has risen from 9.8% to 10.6%. ◆

On March 23, 2016 The Advanced Finance & Investment Group LLC (AFIG Funds), one of Africa's leading private equity fund management companies, announced the promotion of Stéphane Le Bouder to Managing Director in March.

AFIG Funds is headquartered in Dakar, Senegal, and is the manager of the Atlantic Coast Regional Fund (ACRF), a $122m growth and expansion fund with investments across West, Central and East Africa. Before joining AFIG Funds, Le Bouder served as Deputy Assistant Secretary for International Affairs at the US Treasury Department in Washington D.C. An Obama Administration appointee, he worked with senior Treasury and White House officials to advance the Administration's international financial and development agenda. ◆

The East African Venture Capital Association (EAVCA), in conjunction with RisCura, released the first ever dashboard on East African private equity deals, another step forward in the quest for solid investment data on the African continent.

The dashboard shows that Kenya is dominating the region as a hub of private equity activity.

The RisCura-EAVCA East Africa Private Equity Deal Dashboard surveyed 16 funds, of which 13 are EAVCA members, and 63 transactions, which Rory Ord, Executive at RisCura, says provides a fair sample. Of those, the value of deals in 2015 was $152m, up substantially from the 2014 value of $52m.

Growth continues to be a theme, with just over two thirds of the 2015 deal value classified as growth capital. "This shows that the activity is not just about financial engineering," says Ord.

Most of the funds that contributed to the sample invest more broadly on the continent than East Africa, and most of the capital comes from pan-African funds. ◆

PRIVATE EQUITY DEALS Q1 2016 – SOUTH AFRICA

NATURE	PARTIES	ASSET	ADVISERS	ESTIMATED VALUE	DATE
Disposal by	Vantage Capital and African Woman Chartered Accountants Investment to Kleoss Capital	entire stake in TrenStar		undisclosed	Jan 12
Acquisition by	Old Mutual Fund IV (Old Mutual)	significant minority stake in In2Food	Webber Wentzel; Cliffe Dekker Hofmeyr	undisclosed	Jan 14
Acquisition by	Ethos	65% stake in The Eazi Group	Webber Wentzel	R1,6bn	Jan 25
Acquisition by	Amadeus and MTN	undisclosed stake in Travelstart		$40m	Feb 3
Acquisition by	Amadeus Capital Partners	stake in Hepstar		undisclosed	Feb 24
Acquisition by	Nodus Equity	undisclosed stake in Hair City	Webber Wentzel	undisclosed	Mar 1
Acquisition by	Nodus Equity	undisclosed stake in Big Save	Webber Wentzel	undisclosed	Mar 1
Acquisition by	Medu Capital	increased stake from 27% to 100% in Elite Truck Hire		R450m	Mar 9
Acquisition by	Medu Capital	Universal Paints	Hogan Lovells (SA)	incl above	Mar 9
Acquisition by	Convergence Partners	stake in inQuba		undisclosed	Mar 9
Acquisition by	Stanlib	a partnership stake in Exeo Capital		undisclosed	Mar 15

PRIVATE EQUITY DEALS Q1 2016 – REST OF AFRICA

COUNTRY	NATURE OF DEAL	DETAILS	ADVISERS	ESTIMATED VALUE	DATE
Africa	Disposal by	Actis of Emerging Markets Payments to Network International	Morgan Stanley; Perella Weinberg Partners; Clifford Chance; Webber Wentzel; Freshfields Bruckhaus Deringer	$340m	Mar 2
Africa	Acquisition by	Abraaj Group of Themis		undisclosed	Mar 16
Algeria	Disposal by	Mediterrania Capital Partners of its stake in Cellulose Processing to The Abraaj Group		undisclosed	Jan 11
Cape Verde	Acquisition by	Africa Finance Corporation of InfraCo Africa's remaining stake in the Cabeólice Wind Farm		undisclosed	Feb 19
Cote d'Ivoire	Acquisition by	Amethis Finance and West Africa Emerging Markets Growth Fund of an additional stake in Pétro Ivoire		undisclosed	Feb 28
East Africa	Acquisition by	AfricInvest of a stake in Silafrica Plastics and Packaging International	Clyde & Co	undisclosed	Mar 11
Egypt	Disposal by	Abraaj Group of its remaining stake in Integrated Diagnostics Group		undisclosed	Jan 17
Egypt	Disposal by	Amwal AlKhaleej of its investment in Sarwa Capital to the Egyptian-American Enterprise Fund		undisclosed	Feb 1
Egypt	Acquisition by	EFG Hermes of a 76.7% stake in Tanmeyah Microenterprise Services from Qalaa (70%) and Tanmeyah management (6.7%)	EFG Hermes Investment Banking; Arab legal Consultants; KPMG	EGP345m	Feb 24
Egypt	Disposal by	MENA Infrastructure of its 30.33% stake in Alexandria International Container Terminals to Hutchison Port		undisclosed	Mar 7
Ethiopia	Acquisition by	54 Capital of an undisclosed stake in Addis Pharmaceutical Factory		$30m	Jan 6
Ethiopia	Acquisition by	Schulze Global Investments of a 45% stake in MB Plc, the producer of Family Milk		undisclosed	Jan 22
Kenya	Acquisition by	The Norwegian Investment Fund for Developing Countries (Norfund) of a minority stake in Freight-in-Time		$10m	Feb 12
Kenya	Acquisition by	Andreessen Horowitz of a stake in Branch International (Branch.co)		$9,2m	Mar 30
Morocco	Acquisition by	AfricInvest of a stake in Outsourcia Group		undisclosed	Mar 29
Mozambique	Acquisition by	S2 Africa (Satya Capital and Sonae Distribuicão) of Extra supermarket chain from Africom Delta Corporation		undisclosed	Feb 7
Nigeria	Acquisition by	Synergy Capital of a stake in Africa Terminals		undisclosed	Feb 18
Nigeria	Acquisition by	Synergy Capital of a stake in Suburban Fiber Company		undisclosed	Mar 24
Tunisia	Acquisition by	The Abraaj Group of a 49% stake in JM Holding, the majority shareholder of Société d'Articles Hygiéniques		undisclosed	Jan 18