Catalyst

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PE's high fees, low return trend a concern

Oceana snoek is AIIM abalone

Time to ditch Exchange Controls

FROM THE EDITOR'S DESK

As the end of 2022 hovers into view, South Africa's ability to bounce back from a global pandemic is now being tested by monetary tightening that is almost as unprecedented in pace and scale as the money printing that accompanied the global response to COVID-19.

US money supply growth has slowed to +4% year-on-year, down from a peak of +27% y/y in February last year. EU M2 money supply growth is at 6.6% y/y, and Japanese money supply growth is at +3.4% y/y.

Over the past six months, US M2 money supply has barely budged. The money supply impulse behind inflation, and growth, is clearly behind us.

With that, asset prices are resetting with all the concomitant volatility that is ushered in, as equities, bonds, property and alternatives all search for a new normal.

And signs across the globe show that growth is slowing. The consensus estimate is now a 73% chance of recession in the EU over the coming year, a 60% chance of recession in the UK, a 50% chance of recession in the US, and a 33% chance in South Africa. Broadly speaking, emerging markets have much lower probabilities of recession in the next 12 months than developed markets.

Of particular concern is tightening financial conditions across the globe. The Bloomberg Financial Conditions Index (BFCI) tends to move in the same direction as GDP growth and, through to September 2022, we have seen a deterioration in the BFCI, which suggests an impending slowdown in the US.

It's the same situation in Europe, with a sharp deterioration in the Bloomberg Financial Confidence Index through to September 2022.

Not the sort of macro conditions supportive of active expansionary dealmaking.

GPs will still be actively involved in their underlying portfolio companies; having helped navigate them through the treacherous waters of the global pandemic, they must now trim their sails to steer a course through a possible global recession.

Adding to the pressure on GPs is the fact that local LPs are starting to question the low return trend emerging over the last few years (see page 1), one that threatens to halt the expansionary forces driving fund raising, and the growth and transformation of the private equity industry.

There's much to consider for the new head of the industry organisation, Tshepiso Kobile, who was appointed on 1 November 2022. Kobile succeeds Tanya van Lill, who served SAVCA for over five years, and she will have her hands full in her first full year in charge. ◆

Michael Avery

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LPs starting to get uncomfortable with PE's high fees, low return trend

The tide of global liquidity has turned decisively and as it recedes on the pull of higher global interest rates, prompted by runaway global inflation, investors are getting a glimpse of who has been swimming naked.

The local private equity industry has been battling to shake off the COVID period.

Despite attractively priced assets, the lure of remaining listed companies declining, and a swift bounce back from COVID for the broader economy, Private Equity suffered its annus horribilis last year.

Private equity investments totalled R14,9bn in 2021, a marginal increase from R14,5bn in 2020.

But the number of deals was still the lowest since 2011, and the value is less than half of what the local industry attracted at its peak in 2018.

Fund raising remains tough for South African private equity GPs as evidenced by the latest Southern African Venture Capital and Private Equity Association (SAVCA) survey, which shows that Funds Under Management increased by 5.6 percent to R206,2bn, down from a 5.8 percent increase in 2020.

Siya Nhlumayo is a Partner at Vuna Partners, with over 12 years' experience in mid-market private equity, and he is concerned about the emigration trend's impact on deal flow.

"If you add on some of the specific South African risks where entrepreneurs are looking to leave the country, they are taking their skills abroad," says Nhlumayo. "I think there's a lot of opportunities for

Siya Nhlumayo

mid-market focused fund managers to source deals, however, it does create challenges in terms of who's going to continue leading these organisations."

Nhlumayo believes the emigration trend has supported deal flow, but it is taking a bit longer to complete transactions because GPs now have to consider things like succession, and who the second-generation management team is that will close the gap.

On review, the 37-page 2022 PE Industry Insights Survey includes detailed industry analysis, but fails to provide any data on the two things that matter to investors: investment performance and fees.

Is this a deliberate choice to overload the public with data while hiding critical information, or merely an oversight? Can it be that the PE industry is hiding its superior track record in fear of embarrassing fund managers operating in a less lucrative part of the investment industry?

Phathutshedzo Mabogo, Acting Chief Investment Officer, Eskom Pension and Provident Fund, believes it would be unfair to judge managers on a one-year basis, but is starting to grow concerned about the lack of performance being delivered in the local market.

"We're not wanting to make any decisions based on what happened over a 12-month period, but the numbers don't look great," says Mabogo. 'It's quite uninspiring if I'm being absolutely honest. And it hasn't been good for a while."

Mabogo acknowledges that the South African economy's anaemic growth has to shoulder some of the blame because it's an asset class that, for the most part, will

"We're not wanting to make any decisions based on what happened over a 12-month period, but the numbers don't look great," says Mabogo. 'It's quite uninspiring if I'm being absolutely honest. And it hasn't been good for a while."

invest in South Africa. And for as long as South Africa is not looking good, there's no growth. You don't expect the portfolio companies you're investing in to perform.

The Eskom Pension and Provident Fund is one of the biggest supporters of local private equity, and when its acting CIO speaks, the industry better pay attention.

Mabogo raised serious concerns around the growth of funds being raised while transactions aren't showing commensurate growth, leading to a potential bubble.

Langa Madonko

"We've been discussing with the GPs, particularly around returning capital to investors and whether there's – if you look at the growth in funds under management versus the number of transactions happening out there – a bit of a mismatch, because it looks like funds under management have continued to grow, while transactions are not growing. There's a lot of capital chasing the same transactions and I'm hoping that's not the case, but that's something we're watching quite closely. We have experienced something similar on the continent; in Africa, excluding South Africa, and that didn't end well. So the hope is that those numbers pick up. There's a lot more transactions to be done out there… more exits, and there's a lot more capital to be returned to investors."

Langa Madonko, SAVCA Board Member and an Investment Principal responsible for Investor Relations at Summit Africa, acknowledges that dealmaking in the sector is becoming increasingly difficult.

"I do think there are a significant number of managers that are in the market, but we are seeing quite diversified strategies and approaches to investing," said Madonko.

"We know that there are some businesses that are focusing once again on taking advantage of the transformation imperative, and they've positioned themselves to play, particularly in that space, where they can become a transformation partner to some businesses that were plateauing or tapered off. I think one of the things that we have to take into consideration is that a significant proportion of our economy is in that SME to mid-cap space, and many of those are not listed, so they would not have been able to attract capital in the way that they would have needed. Also, because of the lack of scale, they would also not have been able to attract bank capital. So a lot of the private equity solutions that are coming in are going into that space. But I do think that, to some extent, there is a need, especially from an LP side, to determine how the strategies differentiate themselves. And one of the considerations is going to be around how the teams are originating the transactions. If it's always going to be a market process, then we are going to have the challenge of capital chasing after the same set of transactions."

Madonko is quick to add that South Africa has failed to attract its historical levels of foreign direct investment. And this new, local private equity capital formation is one of the things that's going to drive growth in the mid-market space and potentially drive the growth of new segments in the market by allowing the formation of this new capital. This is needed for us to advance the economy and maybe even solve the Eskom problem.

But that still doesn't explain away the cost concerns that investors have with an asset class that is sold as delivering uncorrelated outperformance of the listed equity market and commands an illiquidity premium on top of that.

Coming back to the issue of performance versus costs, Mabogo says it's a continual conversation that the EPPF is having with its GPs.

He believes that two and twenty ("two" means two percent of assets under management and refers to the annual management fee charged by the fund for managing assets, while "twenty" refers to the standard performance or incentive fee of 20 percent of profits made by the fund above a certain predefined benchmark)

Phathutshedzo Mabogo

is appropriate for South Africa because funds raised are generally small.

"Funds are being raised between R600m, maybe a billion rand and two percent is probably appropriate," says Mabogo. "We would obviously have been raising the issue that when we do private equity offshore, those rates are much lower. You're looking at one percent, sometimes even lower than one percent, maybe no more than 1.5 percent. But that's because they raise much bigger funds. But our view on that is that for as long as we're going to try and remain at two and 20 percent base fee, we then need to see performance, because if you're charging two percent and you're not getting to the hurdle rate, it becomes a bit more difficult for us to justify to our investment committee. If you charge two and 20 and return 15 percent net, for example, then it doesn't matter because you know you have returned our fees, right? So it's fine for as long as there is performance."

The problem arises when you look at the returns being delivered over the last few years; it's becoming increasingly difficult justifying shifting from listed to unlisted because investors would generally be expecting the unlisted assets to provide two percent or three percent above listed markets. And that hasn't happened for a while.

"Let me just make it clear that this is not me suggesting that EPPF has lost faith in private equity," stresses Mabogo; "We haven't. We are just saying that there are some issues out there and we need to talk about them with the investors, with the GPs and find a way forward, because we want South Africa to work. There's no point in us suggesting that we're not going to invest in South Africa, take the money offshore, kill the local industry, because in any case, 10, 20 years from now, I'll be in South Africa, my children will be in South Africa. So we need South Africa to work. What we're saying is, is there another way of looking at this? Is there support that GPs maybe need to do better than they are right now, because when they do well, we do well. It's that simple really."

The time has come for tough conversations in the industry. ◆

Oceana's troubled waters provide fertile fishing for AIIM

Oceana, the owner of heritage fishing brand Lucky Star, has had to deal with a fishy smell hanging over the company ever since accounting concerns were raised over its treatment of US Subsidiary, Daybreak.

Mustaq Brey

Earlier this year, it revealed that it had been awarded lucrative fishing rights in five key species for the next 15 years. It seems odd that the fishing allocation rights were awarded to the company while in the middle of a forensic investigation and battling to produce audited financial results for the year to September 2021. After the JSE insisted that the company play open cards, providing details of the ENSafrica forensic investigation and committing to a date for the release of the financials, company secretary, Adela Fortune resigned. This is the third sudden departure of a top management official from the company.

The smell has weighed on the share price and forced the company to dispose of certain assets to support the balance sheet, providing an opportunity to turn snoek into abalone for a private equity consortium led by African Infrastructure Investment Managers (AIIM) to acquire Oceana's CCS Logistics in a R760m deal announced in early October.

AIIM and its investment partners, Bauta Logistics and Mokobela-Shataki Consortium, have a clear strategic intent via the establishment of a US$150m pan-African cold chain logistics platform, Commercial Cold Holdings (CCH), to ensure food security in the region. Funds managed by AIIM intend to invest up to $150m in the platform, inclusive of the initial CCS acquisitions and a pipeline of further acquisitions and greenfield development projects.

The transaction was financed by a mix of equity and debt financing. AIIM, through its flagship South African IDEAS Fund and pan-African AIIF4 Fund, will have a controlling 59.2 percent stake in CCH. CCS has been operational for over 50 years and is an established leader in South Africa's temperature-controlled logistics (TCL) market. CCS currently operates about 100,000 pallets of storage across six facilities in Johannesburg, Cape Town and Walvis Bay, Namibia.

As the global population grows and demand for food supply chains increase, demand for temperature-controlled logistics is also on the rise. This transaction, therefore, signifies AIIM's entry into the cold storage sector, which seeks to establish a pan-African cold storage platform.

Speaking to Musteq Brey – the CEO of Brimstone, a 25.04 percent shareholder in Oceana – about the fishing firm's governance travails, he is confident that the ENSafrica forensic audit and leadership changes will steer the company into calmer, more productive waters.

Fishing firms have been particularly hard hit by rising diesel costs, and while cold storage is a key part of the value chain, one doesn't have to own the asset outright, so clearly the need for liquidity in the medium-term trumped continued ownership.

There has been a raft of changes at Oceana in recent months, with the departures of the CEO, CFO and its auditors, PwC. This would certainly be cause for concern for any shareholders and business partners, but their internal replacements are all recognisable and reputable names.

PwC was replaced by the South African office of the highly respected international French firm, Mazars.

Before that, Oceana replaced Imraan Soomra in February with Neville Donovan Brink, a fishing industry veteran of 30 years, and also replaced CFO, Hajra Karrim, with former Cell C CFO Zafar Mahomed, who left Cell C in August as the mobile operator neared the conclusion of its much-needed recapitalisation.

Damilola Agbaje

Investors will be hoping that these changes and a slimmed down focus will help to restore some battered confidence.

For the AIIM consortium, it is an opportunity to acquire an anchor asset in its plan to build out a cold storage chain of regional significance.

AIIM Investment Director, Damilola Agbaje says that the cold chain logistical infrastructure sector across sub-Saharan Africa is underdeveloped and, in places, non-existent. This investment diversifies AIIM's current portfolio into a high growth and high impact area.

"South Africa, which possesses the continent's most advanced temperature-controlled logistics (TCL) infrastructure at 13m³ of cold storage per 1,000 residents, lags comparable economies such as Egypt and Brazil, which have 105m³ and 83m³ respectively, our research has indicated," said Agbaje.

"TCL infrastructure is critical for both improving sub-Saharan Africa's food security; allowing domestic producers to meet the standards required to participate in global trade; and creating higher value jobs through more formal food retail and wholesale models."

He noted that with current population growth rates, mixed with the rapid rate of urbanisation, the regional deficit in temperature-controlled logistics was expected to worsen. CCH would focus on acquiring and developing facilities with strategic physical locations and, potentially, integration with market-leading food producers, wholesalers, and retailers.

"Anchoring CCH's strategy with such an established player is crucial for the platform's regional expansion. New market entries will leverage CCS's technical expertise and operational track record to secure strategic customer relationships," he said.

The Environmental and Social Management Plan (ESMP) will be augmented to meet applicable environmental health and safety guidelines. An additional environmental and social governance (ESG) hire will be made as the CCS business is being carved out from Oceana to become a standalone business.

Agbaje said that AIIM recognised that cold stores were energy intensive, and would leverage its extensive track record in energy investment across the continent to drive efficiency and improve the CCS generation mix.

"Recently, in South Africa, the power grid has experienced reliability issues. Any worsening of the current supply situation poses a risk and constraint to the TCL sector. By deploying captive renewable energy generation and battery storage with AIIM partner companies, CCH expects to reduce the risk of grid reliability constraints and drive growth," Agbaje said.

Taking pressure off the grid will improve supply to more vulnerable users. Furthermore, renewable generation capacity and improved cooling efficiency will reduce the carbon footprint of CCH toward a neutral position.

He said that up to 70 percent of CCS throughput will come from staple foods that were critical for domestic food security, maintaining a national network of state-of-the-art facilities to ensure a continuous supply of staple foods.

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"This marks the third investment signed by AIIM's fourth generation pan-African infrastructure fund, AIIF4, a thematic investor with a strategic focus on the mobility and logistics, energy transition and digital infrastructure sectors. AIIF4 is delivering on its mandate to construct a diversified portfolio of highly impactful, attractive, growth-oriented platforms across our themes. Food security in the current global and African context is a topic of increasing importance, and we believe the CCH platform will play a role in addressing these critical matters. We look forward to further announcements as AIIF4 continues to expand its portfolio" said Olusola Lawson, Managing Director and co-Head of AIIM.

"Bauta is pleased to be partnering with AIIM and Mokobela-Shataki in establishing this Pan-African cold storage platform. As we build out a network of temperature-controlled warehouses in key demand hubs and food production regions on the continent, we are excited about the role that CCH will play in facilitating intracontinental trade. With the investment announced today, we hope to establish CCH as the pan-African TCL partner of choice" said Michael Osekereh, the Managing Director of Bauta Logistics.

"The acquisition of CCS is a natural extension of our developing partnership with AIIM to create an infrastructure-based platform underpinned by integrated logistics, ports services and cold storage. The acquisition enhances the solid base we have already established and provides us with the cornerstone required to realise our vision to play a meaningful role in key sectors of our economy," said Moss Ngoasheng, founding director of the Mokobela-Shataki consortium. ◆

ENSafrica were the legal advisors, PwC were the financial advisors on CCS, and Frost & Sullivan were the commercial advisors.

No Country for Entrepreneurs

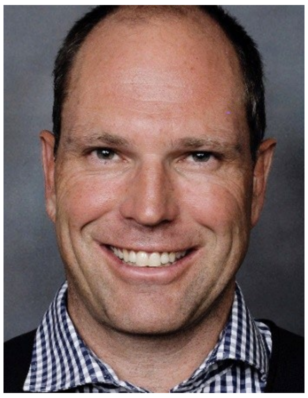
The impact of Venture Capital cannot be measured by comparing its size with other asset classes like private equity or the larger Association for Savings and Investment South Africa (ASISA) membership numbers, which run into the trillions.

At the end of 2021, the South African VC asset class had R8,13bn invested in 1021 active deals. While this has increased substantially, compared with the figures at the end of 2020 where R6,87bn was invested in 841 active deals, according to the latest SAVCA Venture Capital survey, the true value of the asset class is its role in supporting the innovation economy.

This is foundational economics. Innovation is fundamental to the growth in any economy. But for innovation to flourish, there needs to be funding. And the Venture Capital asset class in South Africa is fundamental to that growth.

Stephan Lamprecht, founder of VS Nova, long-time researcher and compiler of the VC survey and advisor to the industry, points out that what we've seen over the last couple of years is that, despite an economy under pressure, the VC asset class has shown relatively robust growth, albeit from a small base.

"I think what's becoming clearer as well is that the role of venture capital is not just limited to funding, but also in keeping skills in South Africa," explains Lamprecht, "because by funding local opportunities, those entrepreneurs are employing people that are able to develop those products and services in South Africa. So the impact is fundamental; it's significant."



Stephan Lamprecht

The numbers in this report reiterate the fact that the VC industry is growing year-on-year, with more early-stage businesses receiving funding and strategic guidance from VC fund managers.

Investment activity, by value of deals, decreased slightly from record levels reported in 2020, amounting to R1,31bn in 2021 (down from R1,39bn the previous year). While we continue to see healthy fundraising, this could lead to more money chasing fewer deals and driving valuations higher. Great news for founders but less so for investors.

There was an 11.4 percent increase in the number of deals, with 129 entities receiving VC investment in 2021, up from 122 in 2020.

The report shows that a significant proportion of all deals (62.3%) were less than R5m in value, with 56.2 percent of all active deals being seed or start-up stage businesses, which has been a consistent feature of the SAVCA asset class, as recorded in previous surveys. This is encouraging because these early-stage investments are the acorns that grow into mighty oaks.

The survey found that fewer fund managers invested in 2021, with various fund managers focused on supporting existing portfolios.

Zooming out to the continental picture, African start-ups attracted a record US$3.5bn (R63bn) in venture capital investment in the first half of this year, bucking a global decline in deal-making linked to worldwide economic turmoil, according to data released by industry group, the African Private Equity and Venture Capital Association (AVCA).

The funding, raised by 300 different companies, represents growth of 133 percent compared with the same period last year.

If one assumes similar growth in the second half, that would take the total invested in African startups in 2022 to $7bn (R126bn), which shows that South Africa, based on the 2021 figures, accounts for less than one percent of continent-wide VC activity, surely a figure far too low for such a large and sophisticated economy.

As Lamprecht explains, one of the major constraints remains the continued imposition of exchange controls which are anachronistic in a modern open economy: "Basically, what it comes down to is that when you want to scale globally, you will want to raise funding in that market. So, for example, it's very clear in South Africa that our advantage is our cost base in terms of having local access to skills. We have very good skills locally, and those people are paid in South African rands; that's fine. But if you want to set up in the US, in Europe, or even China, to tap into those markets, you need to set up people and processes in those countries. To be able to do that means that you need to have funding that is based in those territories, not funding that is South African – simply because we don't have those quantums available in South Africa. And from an exchange control point of view, the physical barrier or impediment of moving money across borders is significant. If I need to pay a salary for my developer, who is currently sitting in Amsterdam, I first have to get Reserve Bank approval to do that; I can't operate. So that creates operational challenges for companies. The repatriation of that money and associated tax issues contributes to uncertainty."

From an entrepreneur's point of view, the impact that exchange control is having on South Africa's local entrepreneurial ecosystem is shocking.

Lamprecht believes that the bottom line now is that if you have a business with global market appeal, with a product or that kind of intellectual property that you want to commercialise, you have to set that up offshore in order to minimise dealing with Reserve Bank approvals linked to exchange controls.

There has been some leniency from the Reserve Bank and from the tax authorities, but it is not practical.

"We're talking about companies that are taking six to 18 months to get approvals, and yet we're talking about start-up entrepreneurs, people that need to focus and keep their eye on the ball. With limited resources, they still have to navigate red tape, trying to hunt down government officials to get stamps of approval. It's ridiculous. From that point of view, we really are shooting ourselves in the foot."

Clearly, some work is ongoing in the form of lobbying Treasury to change the system. Judging by the approach taken to Section 12J, where some people were taking advantage, the impact had stimulated much needed additional capital flows into the class, but the baby was thrown out with the bathwater. It seems VC is not very high up on Treasury's priority list.

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When we talk about priorities from a taxation point of view – mining, minerals, financial services, that's clearly where the priority lies. Treasury seems to think that entrepreneurs are based in a basement in Cape Town somewhere, and that's why it's been on the back burner to a large extent.

"And the easy thing that you hear from the regulators is 'show us the data, show us the impact'. But a lot of the implications of our regulatory constraints unfold over many years. I spoke to an entrepreneur earlier this week. It's a well-known company that's in the financial services space, and they received Reserve Bank approval for a part of their transaction almost eight years ago. The implications of that approval are only now unfolding for them, at a time when they are trying to get their next round of investment. So, to go to the authorities with these business cases is very difficult because you are not always aware of how these things are going to unfold in the future, and what's going to be the impact for the start-ups themselves."

A short survey was distributed amongst a few start-up entrepreneurs during the Case Studies research project, using the networks of Endeavour, Silicon Cape and SiMODiSA.

Out of a sample of 52 respondents, 81 percent moved their business offshore to raise investment from international investors. 85 percent of the sample ended up having to set up an offshore company. Two thirds of the 52 respondents were required by their investors to set up an offshore company, with almost 70 percent reporting that setting up the offshore company was a prerequisite of the investor prior to concluding the transaction.

49 of the 52 respondents ended up setting up an offshore company as indicated above. The US was the preferred choice for setting up a new company (34.7 percent of those with offshore companies), followed closely by the UK and Ireland (30.6%). The state of Delaware in the US was the prominent legal jurisdiction for those targeting the US. Mauritius was the preferred choice for non-South African jurisdiction on the African continent.

55.8 percent of respondents reported the need to physically relocate some of the company's staff to the offshore company, with only 7.7 percent reporting having to move the founders and entire staff compliment to the offshore location. 26.9 percent of respondents reported not having to move anyone to the offshore company.

32 of the respondents had employees or founders move to the offshore company, amounting to a total of 169 individuals. 122 of those individuals and their families formally emigrated.

When asked what the number one reason was to relocate away from South Africa, 32.7 percent cited the ability to attract foreign investment as the primary reason, followed by 23.1 percent selecting the limitations of Exchange Control as the primary reason.

Relaxing exchange controls, easing the movement of intellectual property, and making it easy to set up a foreign base for the local operations were cited as the main reasons for reconsidering the move abroad.

32.7 percent of respondents would relocate back to South Africa if Exchange Controls were scrapped. 25 percent would relocate if they were able to keep the IP offshore without any future actions, including taxing from the SA government.

> When asked what the number one reason was to relocate away from South Africa, 32.7 percent cited the ability to attract foreign invstment as the primary reason.

Clearly, this is no country for entrepreneurs, but that could change with the stroke of a pen. ◆

Appetite for private equity set to soar over coming decade

Globally, private equity remains the top investment choice among alternative investment categories, according to a recent survey conducted by With Intelligence.

Andrew Bahlmann

It found that while investors and fund managers are bullish on both private equity and hedge funds, the former is leading the way in investment intentions.

With Intelligence's latest survey on investor intentions found that 72 percent of institutional and private wealth investors plan on investing in private equity within the next 12 months. Hedge funds were in second place, with 54 percent of the investors surveyed.

In South Africa, this intention is given further impetus by the recent amendments to exchange controls, and Regulation 28 increasing to 15 percent the permitted allocation to private equity, with a further 10 percent to hedge funds – from a previous combined amount of 10 percent. In addition, the retirement fund offshore investment limit was also increased to 45 percent (from 30 percent, with an additional 10 percent African allowance).

South Africa is one of the few countries in the world to still have any exchange controls. In terms of alternative investments, the West averages a 50 percent allocation to them while we have only now increased it to a total 25 percent. I would expect South Africa to follow the international pattern over time, so private equity in South Africa has a bright future.

Andrew Bahlmann

However, the regulator would find it difficult to further increase the allocation of capital to alternative investments, more especially hedge funds but also private equity and venture capital, when boards of trustees of pension funds remain reluctant to use their full current allocation, through misunderstanding the risk nature of alternative asset classes. The regulator would first want to see a greater take-up before extending the allocation closer to international norms.

Regulation 28 now reflects various changes occurring in the world, primarily diminished listings and a growing demand for more infrastructure investment (both a South African and global trend), as well as more capital allocated to private equity and alternative investments, such as hedge funds.

Globally, 2021 was a record year for private equity fund raising. Gridline, a platform that enables investors to invest with top-tier fund managers, has reported average returns of 25 percent to 30 percent among private equity managers. This means that investors in high-quality fund managers will outperform the public markets in the long term, with the latter typically averaging around nine percent and with some analysts suggesting that this may fall to five to six percent over the next decade. While no one can know how long the current spate of volatility will last, it's clear that corporate balance sheets and consumer spending are down, as interest rates and inflation soar.

For similar reasons, there has been a trend for companies to delist from the JSE, with the JSE's latest financial results revealing that 25 companies delisted in 2021.

After a long-term strong run in public markets, there is now rising uncertainty as to where listed markets are headed from here, and investors with foresight are becoming much more interested in private equity.

There are three key advantages inherent in private equity investments. Top of the list is the outperformance mentioned, especially among the top performing managers. A further advantage of investing in private markets is reduced volatility, as they are not priced daily like public equities are. As an example, in early October, listed company Murray & Roberts fell one third in value in two days on a profit warning – that wouldn't happen if it was privately owned.

Thirdly, private markets reduce the psychological anxiety of closely watching every fluctuation in one's account balance and trying to time a sale – which is proven to be almost impossible in public markets.

Private markets compel a long-term mindset in which investors can't just pull their money out any time they panic. This is primarily because private equity investments are typically for seven- to 12-year horizons across market cycles and, therefore, less liquid than public equities. Of course, a private equity investment can be exited – but it's not a daily liquidity. Therefore, the private investor needs to be comfortable being invested for a longer period of time.

After a long-term strong run in public markets, there is now rising uncertainty as to where listed markets are headed from here, and investors with foresight are becoming much more interested in private equity.

Buying low is always a sound investment policy, and private equity is attuned to taking the time to find companies likely to appreciate in value over five to 10 years. With private markets, investors are not entirely at the mercy of external factors, but can influence internal factors by focusing on particular asset classes like ICT and fintech, where the investor can monitor specific inputs that lead to changes in that market.

Another factor which private investors keen to take advantage of the higher Regulation 28 limits need to be cognisant of is the lack of information on such private companies. They don't publish financial information as regularly as listed companies do, so investors are reliant on their fund manager keeping abreast and providing updates and visibility on the portfolio. For this reason, it is critical to choose from among the best managers, as the difference in return between managers can be a multiple of the difference between returns from exchange-traded equity managers.

Much of the excitement and potential around private equity is in the fintech space. There is growing interest in South African start-ups from international private equity, but just as interesting with the amendment in exchange controls is that South African private equity can invest more in international start-ups. We may expect to see a lot more liquidity in the local venture capital market, for instance, driven by interest from international investors.

According to the South African Venture Capital and Private Equity Association (SAVCA), in 2021, South African start-ups attracted more than $800m, with a number of high-profile fintech deals announced in 2022 so far. A secondary trend is that South African tech start-ups are expanding internationally, typified by companies such as Mobiz expanding to the US; artificial intelligence (AI) company, Carscan, which now has clients in countries such as India, the UAE, Nigeria and Kenya; and Sendmarc is actively doing business in several Western countries.

Such investments would potentially become available to private equity investors. ◆

Bahlmann is Chief Executive: Corporate and Advisory | Deal Leaders International

Reg 28 amendments offer pension funds clarity and regulatory certainty

Regulation 28 (Reg 28) is the regulatory instrument that determines the allocation limits per asset class and per individual asset for local pension funds.

Elena Ilkova and Kate Rushton

On 5 July 2022, the final amendments to Regulation 28 of the Pension Funds Act were published as Notice No. 2230 in Government Gazette No. 46649 of 1 July 2022.

The final amendments are the result of two rounds of consultation during 2021, based on drafts published in February and October 2021. The primary objective of the amendments was to create a regulatory framework that enables investment in infrastructure assets. South Africa's infrastructure financing needs far outstrip the government's ability to fund the needed development, and thus private sector participation in building and funding infrastructure is essential. Regulators also took the opportunity to update Reg 28 in several other aspects: a long-overdue separation of private equity and hedge fund investment limits; a prudent introduction of single entity exposure limits across asset classes; a definition (and a prohibition) of crypto assets; and an adjustment of infrastructure-related reporting requirements.

The amendments to Reg 28 will come into effect on 3 January 2023.

In our view, the key points in the final amendments are:

- **Definition of infrastructure:** The final amendments took into consideration most of the criticism levelled at earlier drafts by further broadening the definition of infrastructure. Previous references to ownership classification, user types, and physical asset requirements have been dropped. Infrastructure is defined as "any asset that has or operates with a primary objective of developing, constructing and/or maintaining physical assets and technology structures and systems for the provision of utilities, services or facilities for the economy, businesses, or the public".

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- **Exposure limits:** The overall limit of 45% for infrastructure investment across all asset classes was retained, with the specific exclusion of debt issued or guaranteed by the government. The 25% overall limit per issuer/entity across all instrument types was also retained. Within the asset classes, private equity funds have been allocated a separate 15% limit, but no specific allowance has been made for private debt funds. The debt instruments investment limits retain the preference for listed instruments, implying that the 15% limit for other debt not listed on an exchange will have to accommodate both infrastructure and any other forms of private debt. Hedge funds retain a 10% overall limit, but a sub-category in the previous draft that appeared to specifically reference foreign hedge funds has been dropped.

- **Crypto assets:** The published final amendments were unchanged from the previous draft, including the definition of crypto assets and the prohibition of direct or indirect investment by pension funds.
- **Reporting requirements:** The final amendments retain the revision which requires the specific reporting of infrastructure investments within hedge and private equity funds, which are otherwise exempt from look-through exposure reporting.

WHY THE CHANGE IN REGULATION 28?

The update to Reg 28 is a welcome regulatory action that is long overdue, considering the current version of rules was last updated in March 2011. The developments that have taken place in financial markets over the last decade necessitate regulations to reflect the environment in which pension funds make their current investment decisions. The changes are a reflection of global trends – such as the growth in private markets, particularly private equity as an asset class, the maturity of hedge funds as an alternative asset class, and the more recent rapid rise in the popularity of crypto assets.

Private investment in infrastructure is a global trend too, but it has an additional South African relevance. The decade-long deterioration of both the government's fiscal position and the financial positions of state-owned entities that traditionally provided infrastructure have left the country with little choice but to deliberately encourage private savings investment in critical developments — the modern infrastructure that is required to enable economic growth. In addition to the urgent need for investment, the increasing awareness of environmental, social and governance (ESG) factors is prompting a reconsideration by pension fund trustees of the long-term sustainability risks to which investments are exposed.

The Reg 28 amendments provide the certainty needed to encourage private retirement savings funding of infrastructure that is to be provided by both public and private sector entities. The investment limits in Reg 28 are intended to safeguard retirement savings by preventing excessive concentration risk, while still allowing fund trustees to determine investment policy and make investment decisions that take into consideration the needs of each pension funds' members.

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A comparison of the final amendments with the October 2021 draft highlights the following key differences:

• **Definition of infrastructure:** "'Infrastructure' means any asset that has or operates with a primary objective of developing, constructing and/or maintaining physical assets and technology structures and systems for the provision of utilities, services or facilities for the economy, businesses, or the public." In our view, the new broader definition is a significant improvement because it explicitly recognises the stages in the lifecycle of infrastructure (develop/build/maintain), which allows investors to participate at whatever stage they choose. The new definition also recognises that modern infrastructure is more than physical assets, and that besides traditional public infrastructure, the provision of private infrastructure also enables economic development. In comparison, the earlier draft simply stated that "'infrastructure' means any asset class that entails physical assets constructed for the provision of social and economic utilities or benefit for the public", implying the exclusion of private infrastructure.

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• **Allocation limits:** In comparison to earlier drafts, the final version[1] has not changed with regards to the limits (overall, per asset class and per issuer), but some of the text descriptions in various categories have been updated to clarify the rand amount limits. The most significant text change is in section 11, which refers to overall limits. In section 11 (a), the previous draft stated that the overall limit includes "exposure in respect of infrastructure in the rest of Africa". The final version of Table 1 does not include this wording. However, item 11 in Table 2 (which outlines the reporting requirement), does ask for both the percentage and rand value of infrastructure in the rest of Africa, and the total in the same table specifically notes that it should include the 'rest of Africa' exposure.

The updated Reg 28 offers pension funds clarity and regulatory certainty. Within this context, we believe that the final amendments are a positive development that provides the supportive regulatory framework needed to encourage pension funds to consider investing in alternative asset classes, especially infrastructure. ◆

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1 Final amendments to Regulation 28 https://bit.ly/3E9kscc

PRIVATE EQUITY DEALS Q3 2022

NATURE	PARTIES	ASSET	ADVISERS	ESTIMATED VALUE	DATE
Investment by	Quona Capital, Breega, CRE Ventures, Ingressive Capital, RaliCap, Unicorn Growth Capital and Sherpa Ventures	in Sava Africa		$2m	Jul 1
Acquisition by	Infra Impact Mid-Market Infrastructure Fund I	a significant minority stake in Cybersmart		undisclosed	Jul 7
Acquisition by	Lebashe Investment and management	Mara Phones South Africa (in business rescue)		undisclosed	Jul 8
Acquisition by	Lonsa Everite, Legacy Africa Capital and management	100% of Swartland Investments and Swartland Insulation	Birkett Stewart McHendrie; ENSafrica	R1,3bn	Jul 10
Investment by	Launch Africa, Goodwater Capital, Five35 Ventures and Delta Ventures	in DigsConnect		undisclosed	Jul 14
Disposal by	Actis and Mainstream Renewable Power to Infinity Group and Africa Finance Corporation	Lekela Power	Citigroup Global Markets (SA); Absa CIB	$1,5bn	Jul 18
Acquisition by	Impressa Capital from Adevinta	Gumtree South Africa		undisclosed	Jul 22
Investment by	E4E Africa, Strat-Tech, Next Chymia, Untapped Global, Codec, Ashwin Ravichandran and Kanyi Maqubela	in Qwili [seed funding]		$1,2m	Jul 28
Investment by	Knife Capital, Industrial Development Corporation and Norican	in DataProphet		$10m	Aug 9
Investment by	CapciTech and other investors	in Homefarm		R1,7m	Aug 14
Acquisition by	City Logistics and Clearwater Capital	100% of Fastway Couriers South Africa (70% and 30% respectively) [Fastway Couriers' National Master, Fastway Johannesburg and Fastpost]	Benchmark International; Eversheds Sutherlands (SA); Watermans Registered Auditors	undisclosed	Aug 17
Investment by	Imvelo Ventures, Lebashe Investment Group, Pallidus Alternative Investments, Shaolin Investments and Gary Stroebel	in Cape Town Stock Exchange		R85m	Aug 19
Acquisition by	Mergence Investment Managers through its Infrastructure and Development Equity Fund	a controlling equity stake in Live Easy		undisclosed	Aug 23
Acquisition by	Huge from Msemu Investment Trust and Aloecap Private Equity	30% and 14% stake in Interfile Group	YW Capital; Questco	R44m	Aug 31
Investment by	Knife Capital and other investors	in Octiv [Series A]		undisclosed	Sep 1
Investment by	Vumela Fund	in TSK Interiors		undisclosed	Sep 6
Investment by	E4E Africa	BusyMed		undisclosed	Sep 7
Acquisition by	Revego Africa Energy Fund	stakes in Aries Solar Park, Konkoonsies Solar Park and Soutpan Solar Park		not publicly disclose	Sep 23
Investment by	Alithea IDF, Naspers Foundary, The Michael & Susan Dell Foundation, Futuregrowth Asset Management, Endeavor Catalyst Endeavor SA's Harvest Fund II, Caruso Ventures and E4E Africa	in SweepSouth		R200m	Sep 27
Investment by	Khulisani Ventures (Minrworkers Investment Company)	in Livestock Wealth		R10m	Sep 27
Investment by	Arise and other investors	in iiDENTIFii		$15m	Sep 29
Investment by	Mobility 54 Investment SAS	in Drive to Own		undisclosed	Sep 29
Disposal by	Sappi to Aurelius Investment Lux One (Aurelius European Opportunities IV Funds (70%) and Aurelius Equity Opportunities SE & Co (30%))	Maastricht Mill (Netherlands), Stockstadt Mill (Germany) and Kirkniemi Mill (Finland)	Rand Merchant Bank	€272m	Sep 29