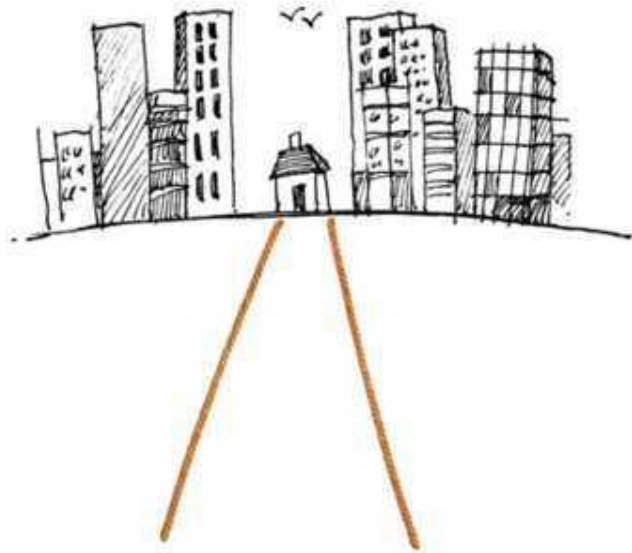




WHAT IS PRIVATE EQUITY?



Straight advice from an independent perspective.

By Malcolm Fair (on behalf of David Moore)

September 2011

RisCura Introduction

RISCURA GROUP

- Africa's premier independent investment consultant and financial analytics provider
- Servicing 7 of Africa's 10 largest pension funds that represent more than USD150 billion AUM and money managers with over USD 5 billion in hedge fund AUM and PE committed capital.

- London
- Cape Town, Johannesburg
- Windhoek
- Lusaka, Accra, Port Louis



RISCURA FUNDAMENTALS

- Independent third party
- Part of the RisCura Group
- Operates separately from RisCura Consulting
- Provide independent valuation, risk and performance analysis to PE GPs and LPs
- Providing valuation services to PE LPs and GPs since 2007

We will be looking at...



- 1 What is private equity?
- 2 Why do companies seek PE funding?
- 3 How are PE funds structured?
- 4 Historic performance of private equity

We will be looking at...



1

What is private equity?

2

Why do companies seek PE funding?

3

How are PE funds structured?

4

Historic performance of private equity

What is Private Equity?

SIMPLY INVESTMENTS INTO UNLISTED COMPANIES

- But the particular way in which this is done is what we know as private equity

Private equity

- Low liquidity
- Long investment horizon
- High active involvement
- Low market efficiency
- No published information
- Low regulatory oversight

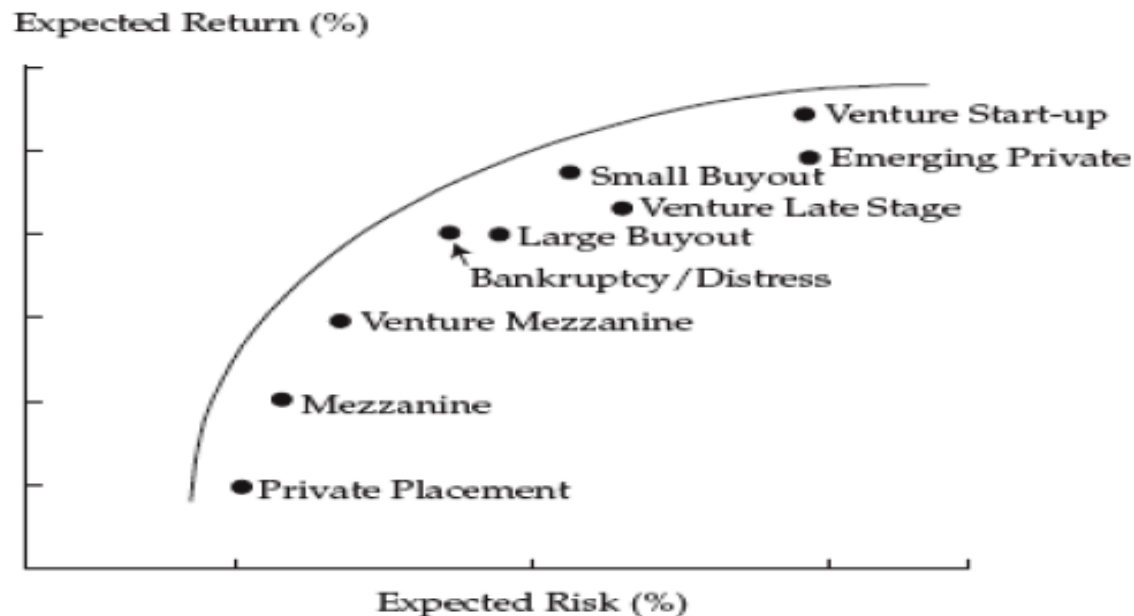
Listed equity

- Strong liquidity
- Short or long term
- Little active involvement
- Higher market efficiency
- Published information
- Highly regulated

What is Private Equity? (cont.)

PROVIDES FINANCE AT VARIOUS STAGES OF FUNDING a BUSINESS

- Venture Capital - seed, start-up
- Expansion - Bridge financing or loans, phased financing
- Buyout - Buyout, MBO's
- Rescue / turnaround - Refinancing Special situation
- Other: Secondary purchase, replacement equity



Source: Froland (2005)

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Historic performance of private equity

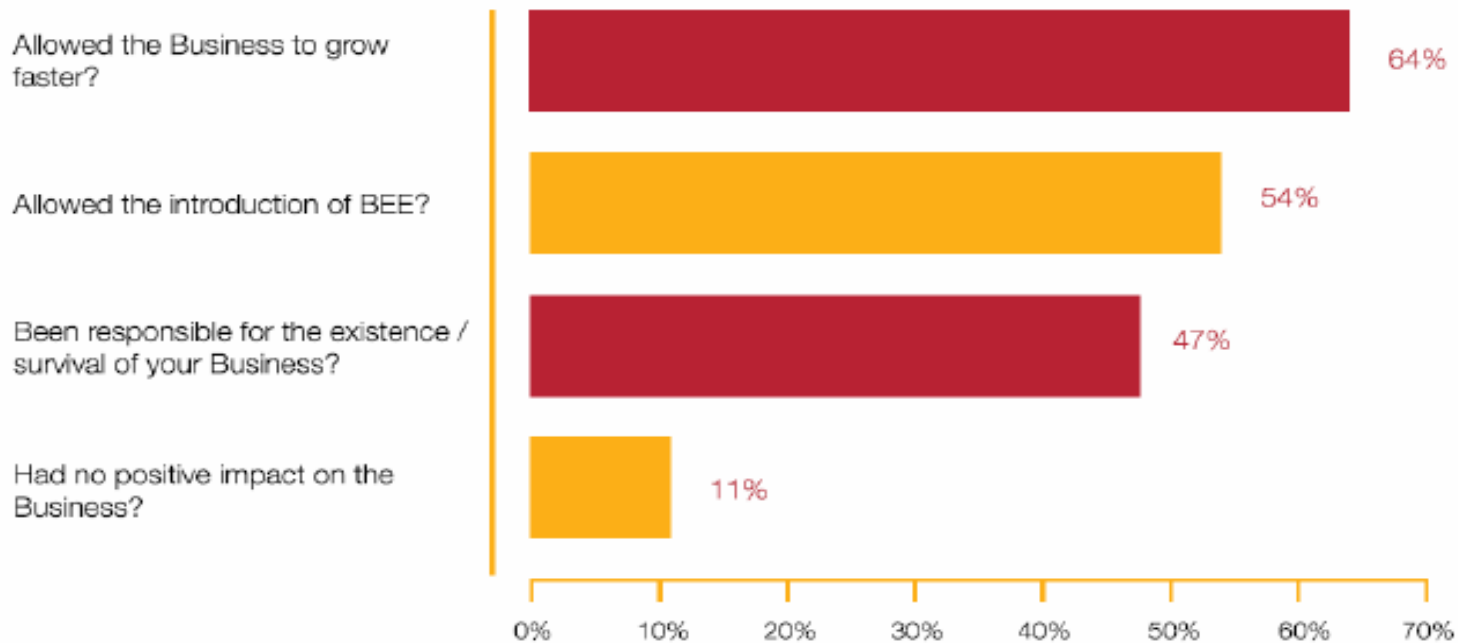
Why do companies seek PE funding?

AN ENTERPRISE MAY SEEK PRIVATE EQUITY FINANCING FOR A VARIETY OF APPLICATIONS, AS FOLLOWS:

- increasing its **working capital** base;
- business **expansion** and development;
- developing **new technologies** and **products** in order to grow and/or remain competitive;
- to **finance acquisitions** of other businesses; and
- to **buy out** certain shareholders in order to **restructure the ownership** and management of the business.

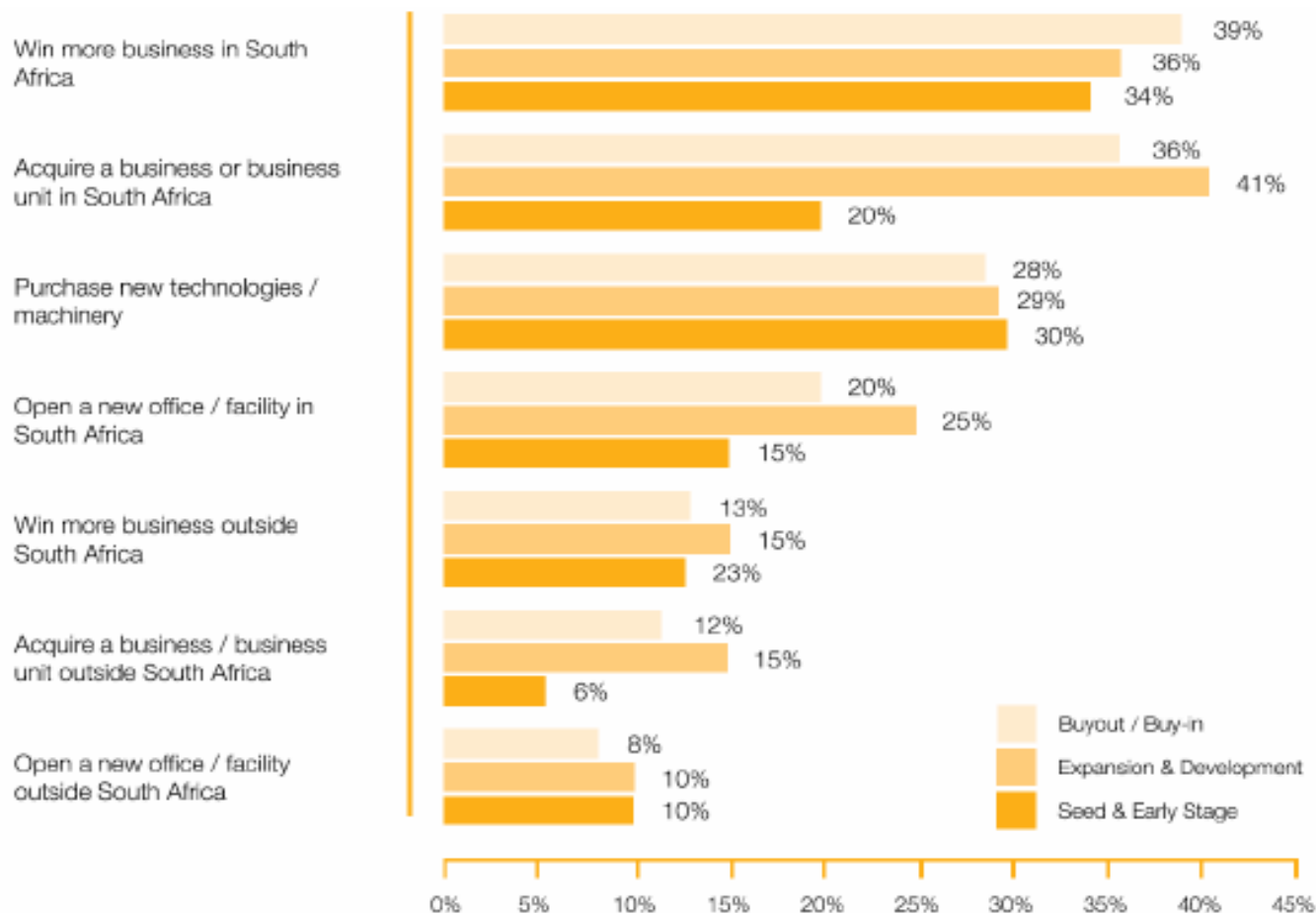
Why do companies seek PE funding? (cont.)

Private equity contribution



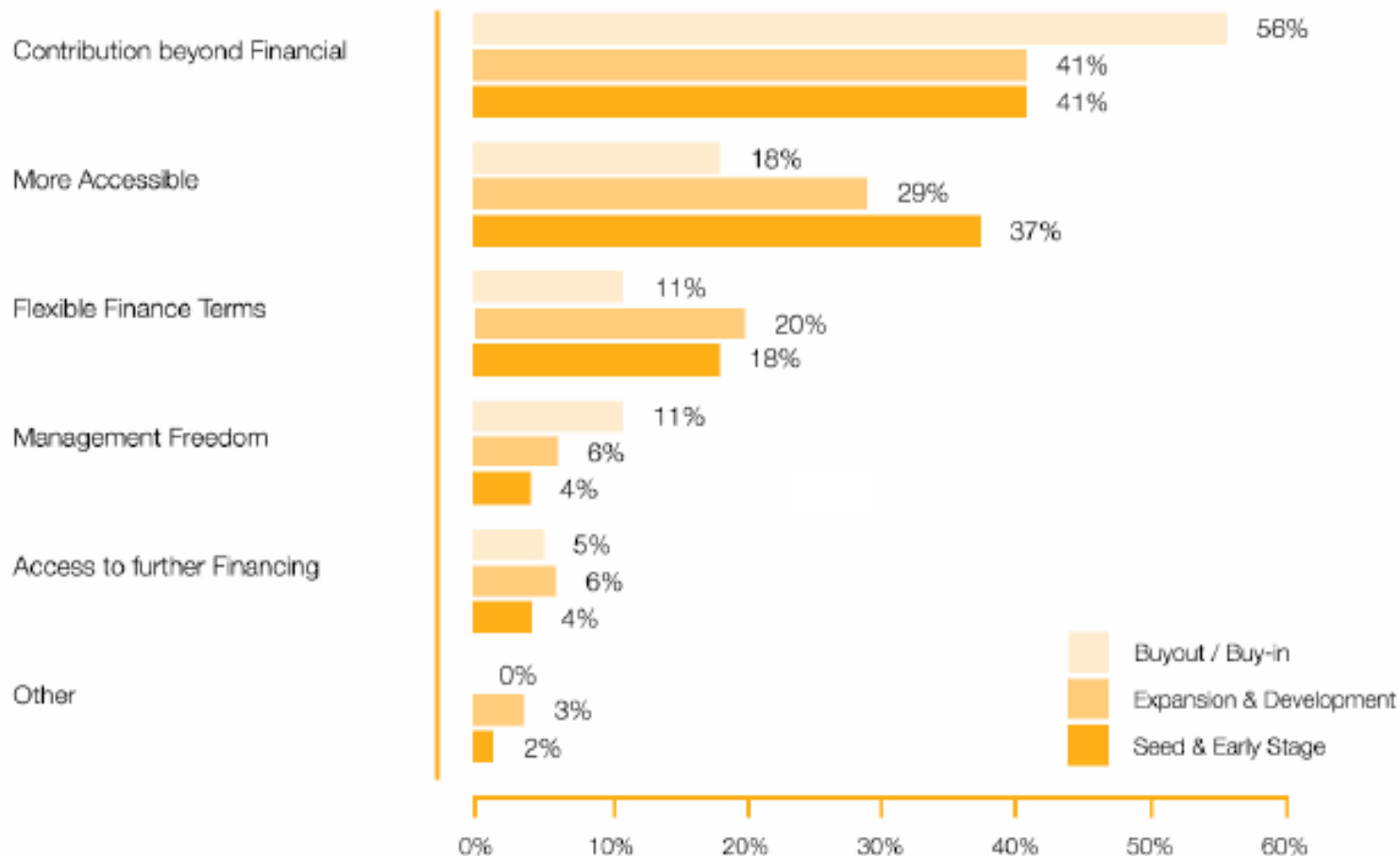
- Companies owned by private equity firms are positive about the contributions made by PE
- Almost half of the respondents to the survey attributed the survival of their business to PE ownership

Why do companies seek PE funding? (cont.)



- Respondents highlighted the **many positive interventions** made by PE managers which have improved their business.

Why do companies seek PE funding? (cont.)

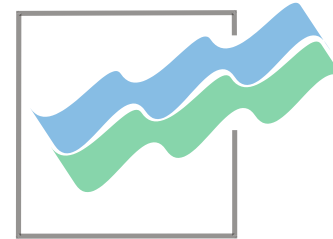


Example: Development Capital for Water

- Located on the South coast of Durban, Siza Water's concession based arrangement services a population of approximately 50,000 people.
- Concession based agreement spanning a 30 year period.
- Incumbent public service provider lacked resources and technical capacity, existing infrastructure insufficient.
- Significant capital investment effected, infrastructure upgraded, service delivery improved and overall efficiency achieved.
- Equity holders value maximised



Siza Water



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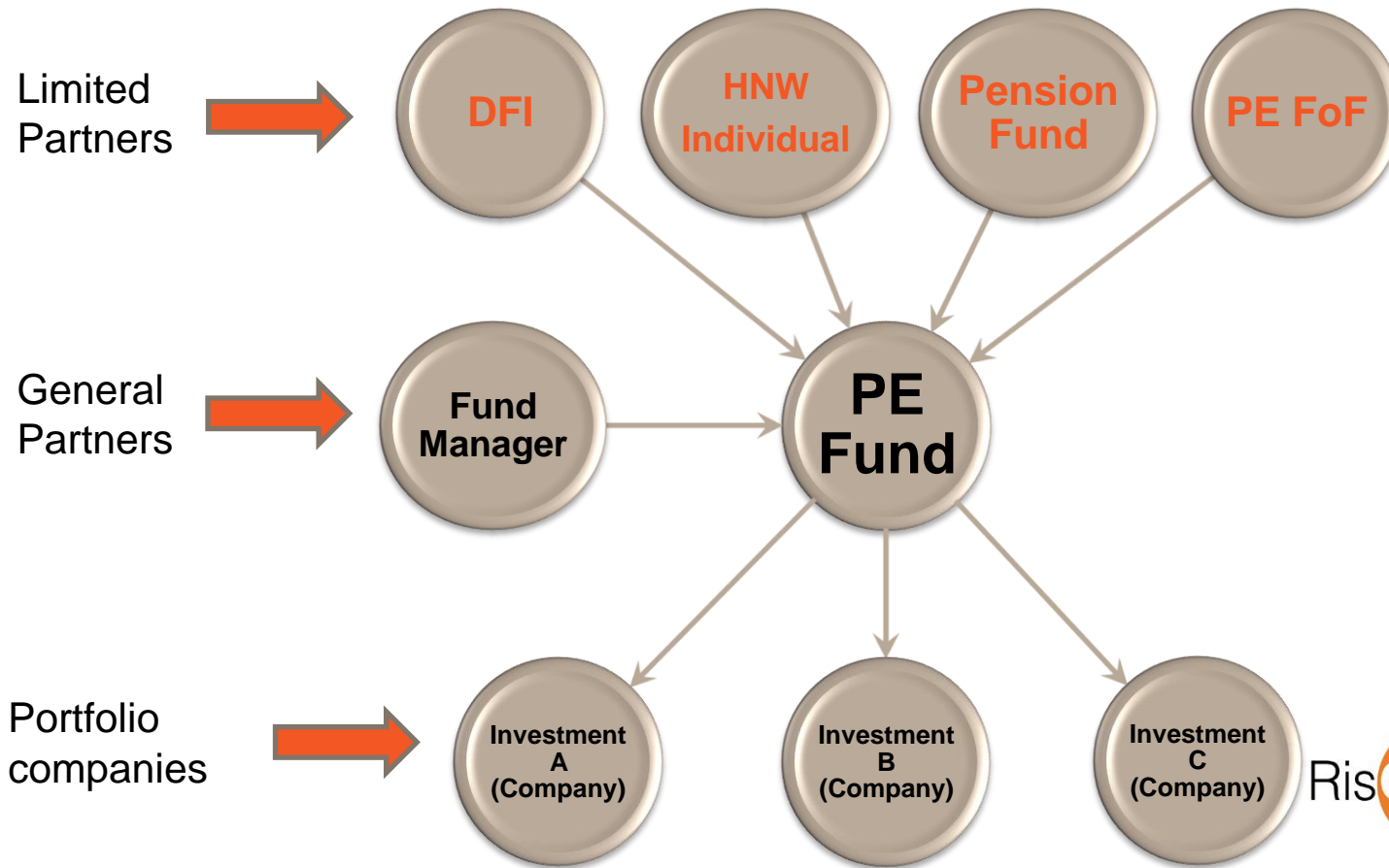
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Historic performance of private equity

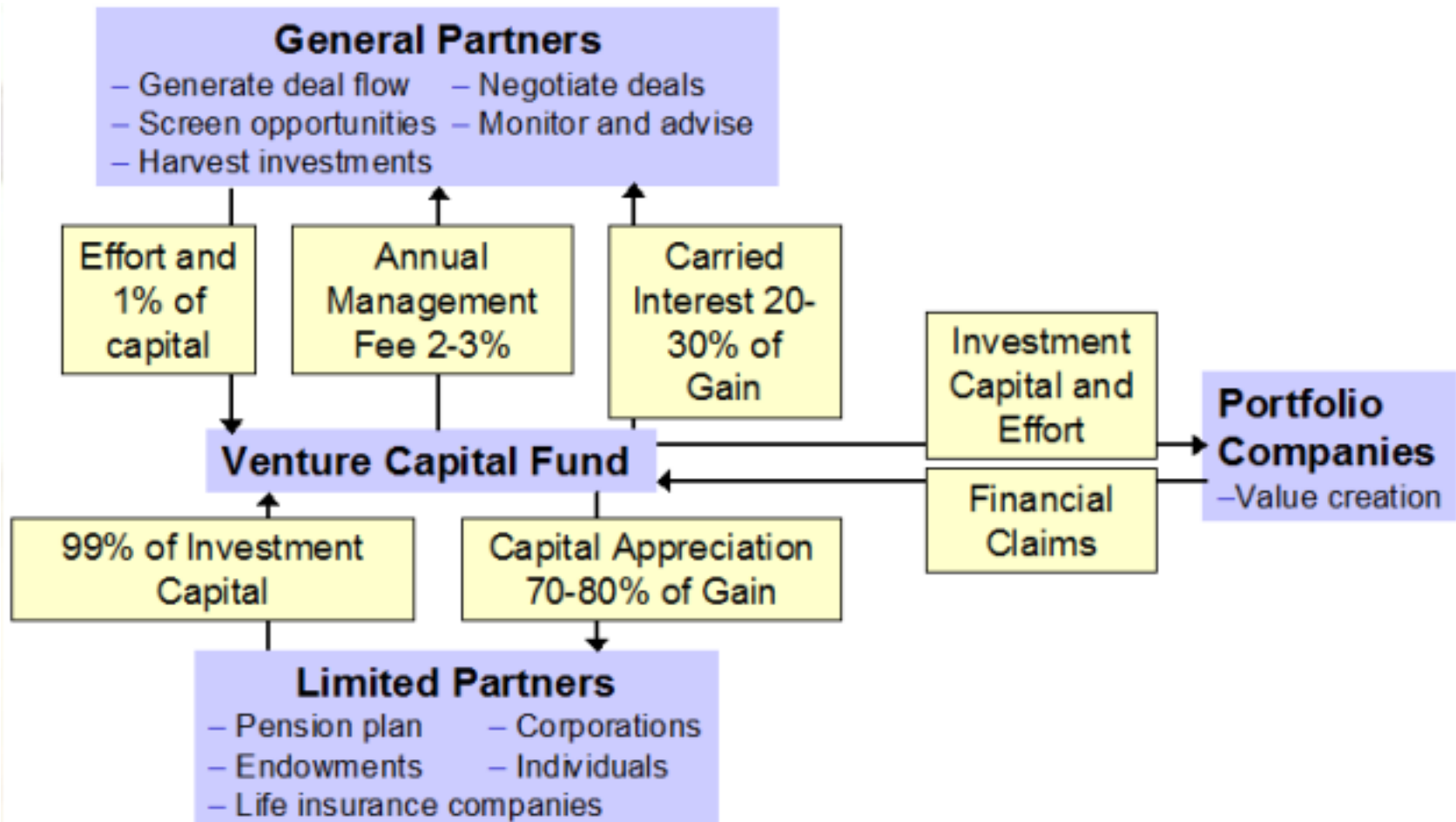
How are PE funds structured?

DIFFERENT TYPES OF FUNDS DEPEND ON FUNDING SOURCE

- **Captive funds** (Government or Other)
- **Independent funds**



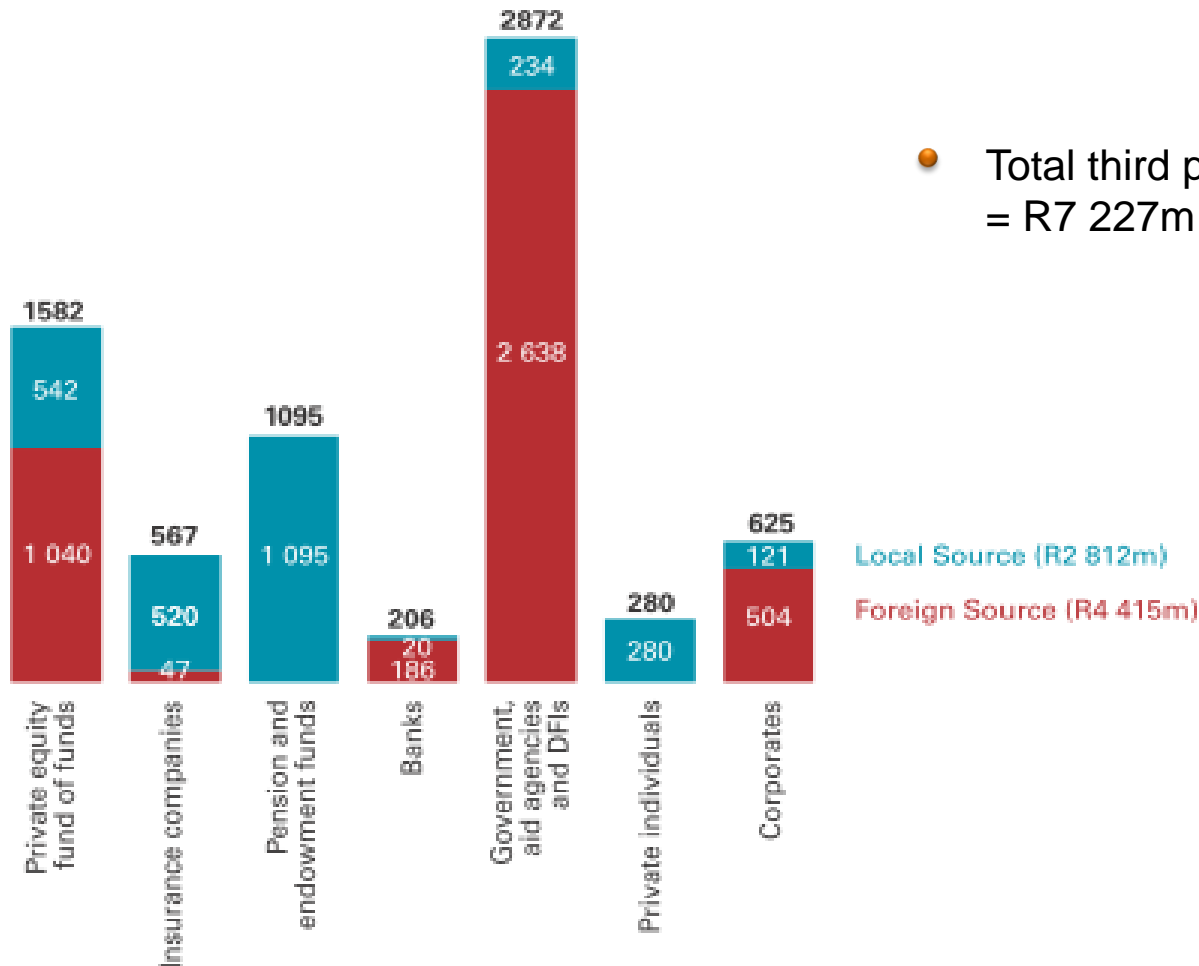
How are PE funds structured (cont.)



Who invests in PE?

INSTITUTIONS INVESTING IN PE IN SA

Sources of third party funds raised in 2008 (Rm)



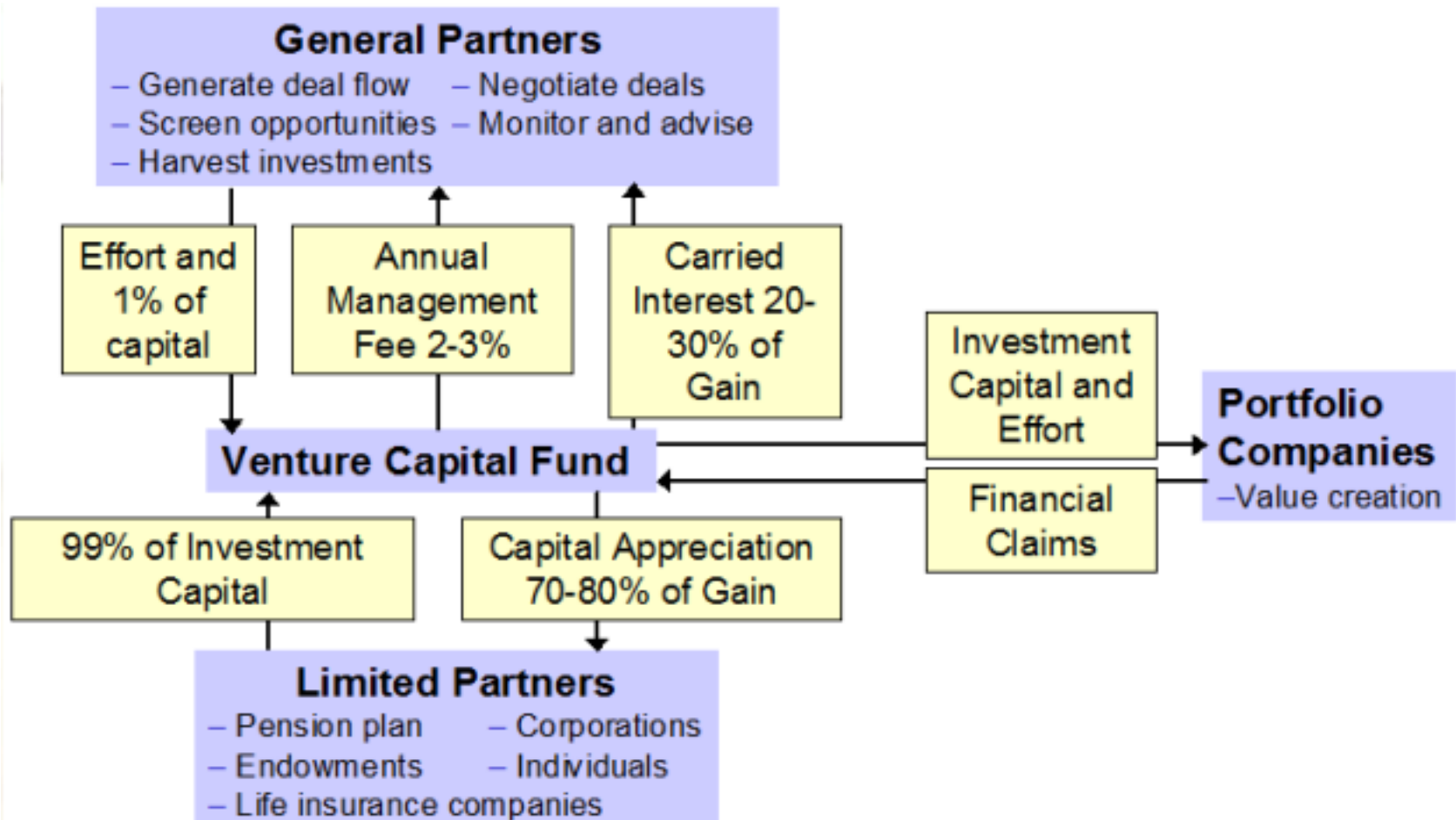
- Total third party funds in 2008 = R7 227m (\$ 1bn)

Who invests in PE? (cont.)

LARGE US PENSION FUNDS' ALLOCATIONS TO PE

Investor name	2005 Allocation		2009 Allocation	
	(\$bn)	(% of AUM ⁸)	(\$bn)	(% of AUM ⁹)
California Public Employees' Retirement System	9.8	5.1	24.3	12.1
California State Teachers' Retirement System	6.9	5.4	15.9	12.1
CPP Investment Board	2.9	3.6	14.1	11.4
Michigan Department of Treasury	5.9	11.0	8.2	17.6
New York State Common Retirement Fund	9.4	6.3	11.6	9.2
Oregon State Treasury	5.1	7.6	9.2	14.1
University of Texas Investment Management Company	1.2	8.4	3.5	22.0
Washington State Investment Board	6.9	5.4	11.5	16.3
Wellcome Trust	2.7	11.5	4.5	20.5

How are PE funds structured (cont.)



How are PE funds structured? (cont.)

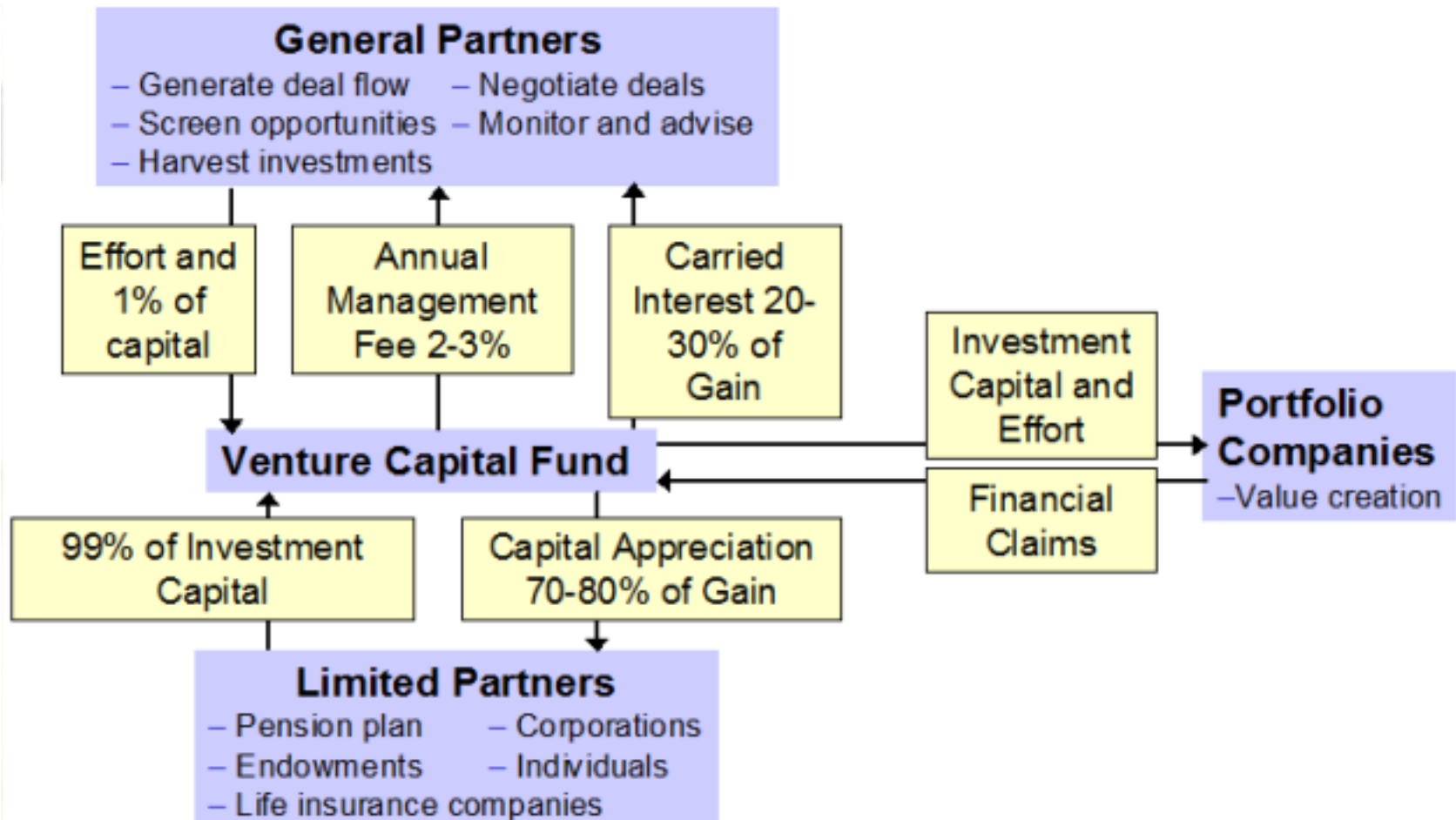
The choice of vehicle for a private equity fund is driven essentially by two factors:

- **tax transparency**; and
- **limited liability** for investors.

Two common structures (depending on fund domicile) to achieve this:

- **Bewind trust** - trustee does not own, but merely administers, the assets of the trust, which are owned by the beneficiaries.
- **En commandite partnership** - The general partner (fund manager) is able to bind the partnership, but *will not enjoy limited liability* and will be liable for all of the debts of the partnership. The limited partners (investors) have limited liability.

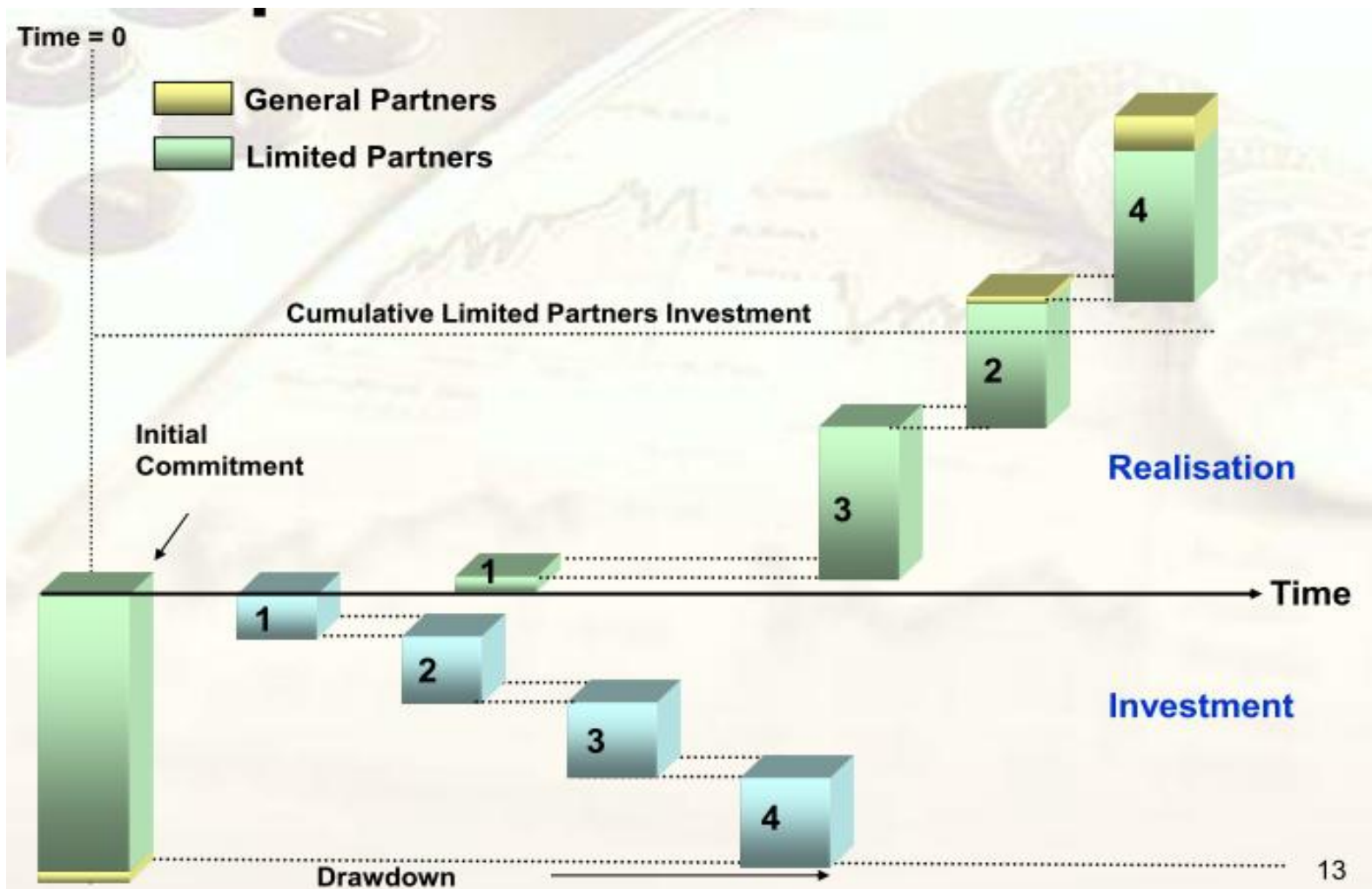
How are PE funds structured (cont.)



How PE Funds work



How PE Funds work (cont.)



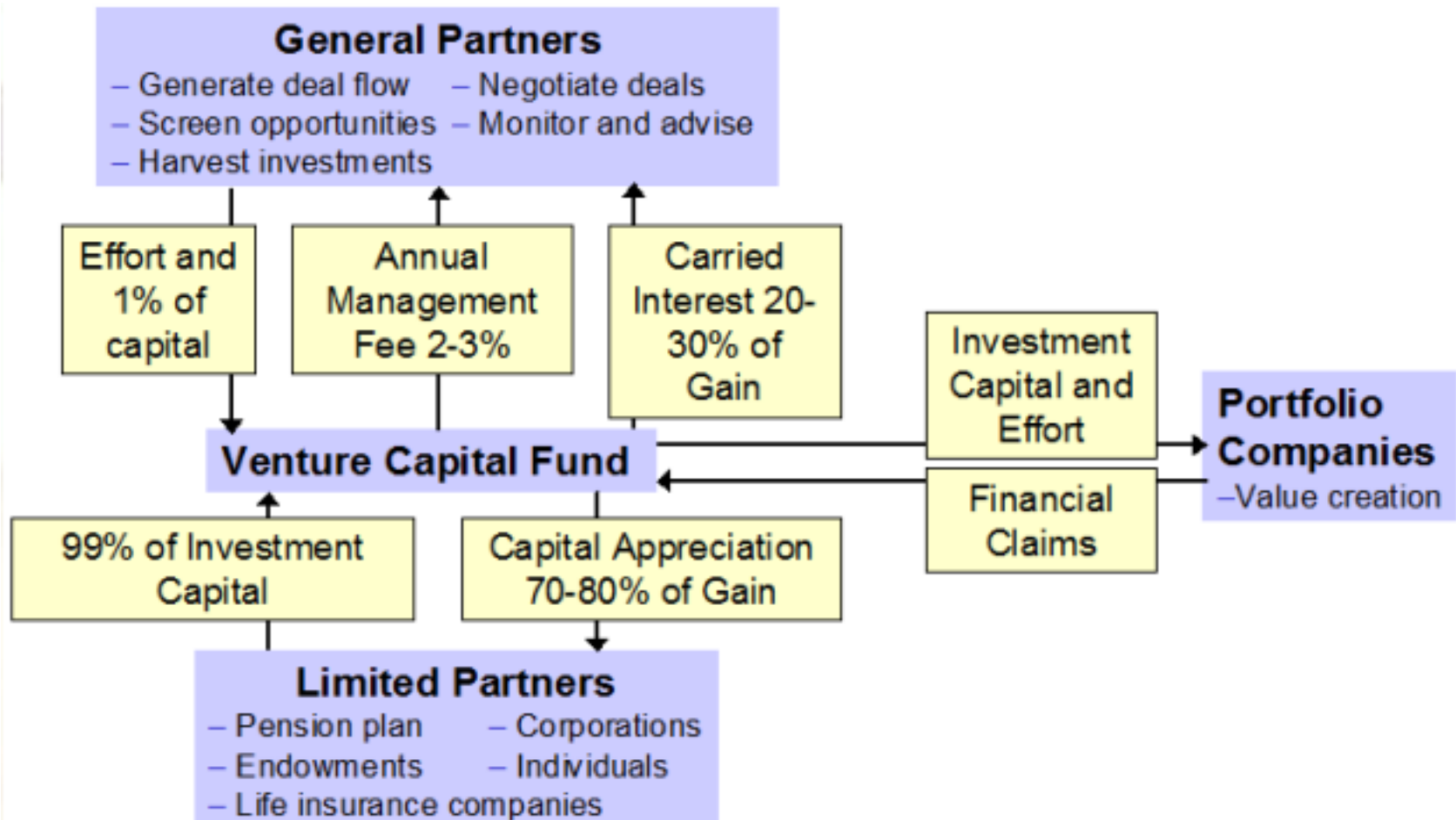
Terms of investment into a PE fund

- **Term of the fund** – fixed-life with a typical term of 10 years;
- **Advisory/Management fee** – typically 1% to 2% of the aggregate committed capital of the fund (may be higher or lower dependent on investment thesis);
- **Hurdle rate or preferred return** – normally 8% to 12% on their committed capital must be achieved before the General Partner or Trustee can receive its participation in the gains and surpluses (again dependent on particular investment thesis);
- **Gains and surpluses** – a participation in the gains and surpluses of the fund (typically up to 20%) is paid to the General Partner or Trustee as a performance fee/preferred return. The remaining 80% of the gains and surpluses is paid to the investors pro rata to their capital commitments;
- **Return of proceeds** – the proceeds of fund investments are returned to the investors as and when the investments are realised and are generally not retained or reinvested by the fund;

PenCom requirements for PE funds (Dec 2010)

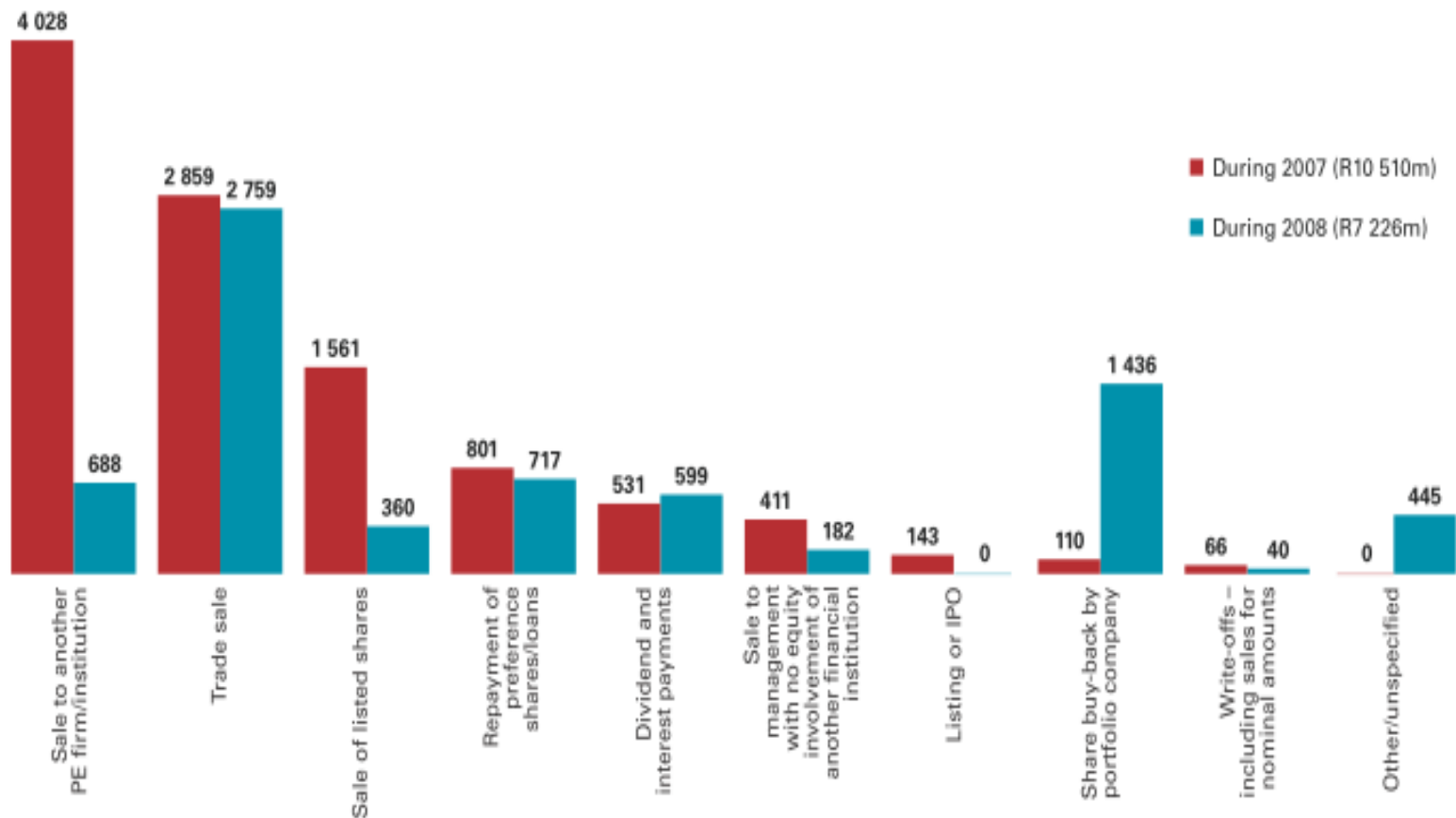
- **Well defined and publicized investment objectives and strategy** – includes disclosure of underlying asset prices and audited financial statements;
- **Pre-defined liquidity/exit routes for the PE Fund vehicle** – Initial Public Offers; Dividends; trade sales; Buy-out instruments for underlying companies
- **Managed by experience Fund Managers** – Experienced in PE specifically; Registered with the SEC as Fund Managers;
- **Key Principals – 10 years PE experience** – No exit without prior notice to the Commission through the PFA; Exit clause expressly included in IMA;
- **5% Investment by the Fund Manager** – as a minimum;
- **DFI or MDFO as LP** – alternatively must have minimum Investment Manager rating of BBB by SEC registered/recognized rating agency;
- **75% invested in Nigeria** – This is a minimum;
- **Advisory Board of majority independent representatives** of institutional investors.

How are PE funds structured (cont.)



PE exits

PE EXITS – MANNER IN WHICH FUNDS ARE RETURNED



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African PE performance history

UNFORTUNATELY NO NUMBERS AVAILABLE FOR AFRICA PE

- RisCura is working to put this in place

BENEFITS OF PE PERFORMANCE INDEX

Make it easier for investors to make the investment decision

- Expected by offshore investors – assists risk assessment processes
- Manage investor expectations and reduce information gaps about industry track record
- Trend of increased transparency

Benchmarking

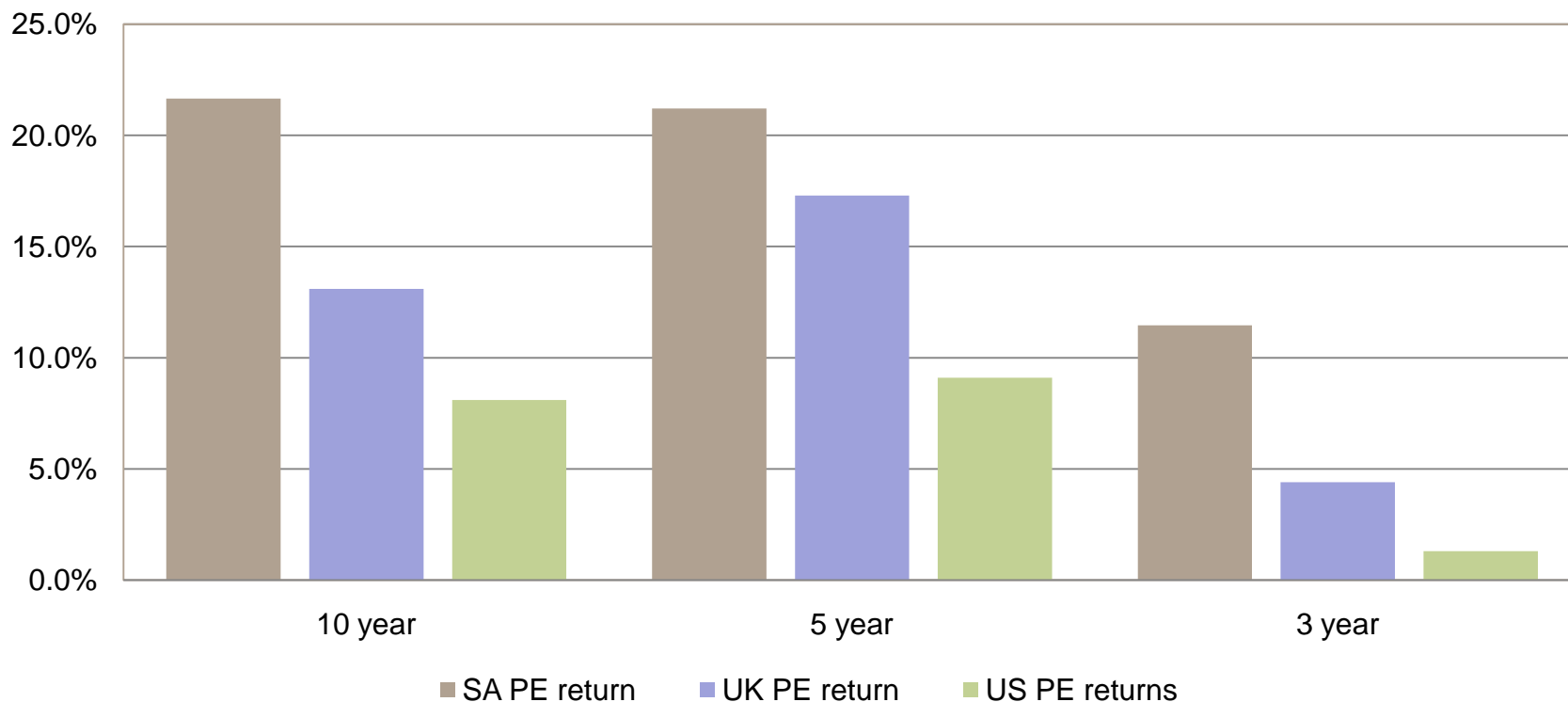
- Help investors to benchmark a portfolio of PE investments
- Managers can benchmark their funds' performance

Industry maturity

- Private equity is growing quickly in Africa
- Time to meet the same standards as the bigger international markets

SA private equity outperforms US, UK

SA pooled IRR vs. developed markets



*Source: RisCura Fundamentals

#Source: British Private Equity and Venture Capital Association Private Equity and Venture Capital Performance Measurement Survey 2009.

‡Source: Cambridge Associates LLC U.S. Private Equity Index September 2010

SA PE compared to listed market (PME)

Public market equivalent results



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Thank you

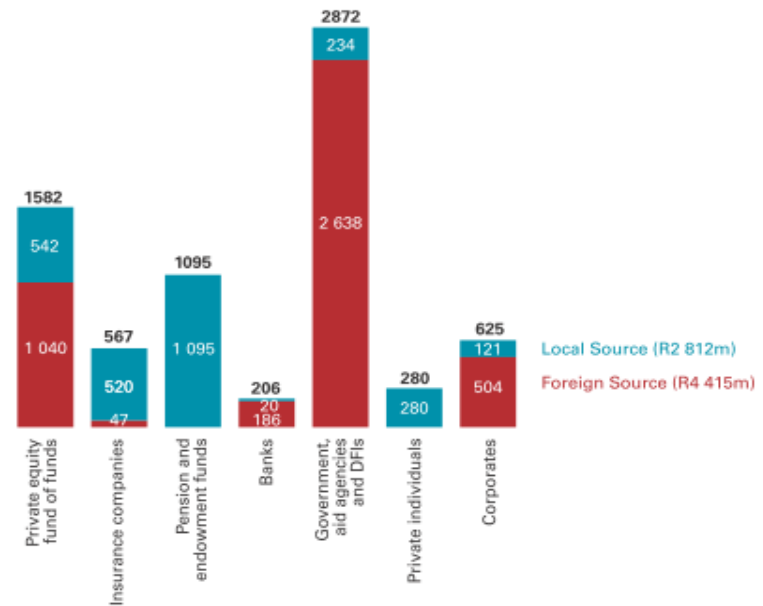
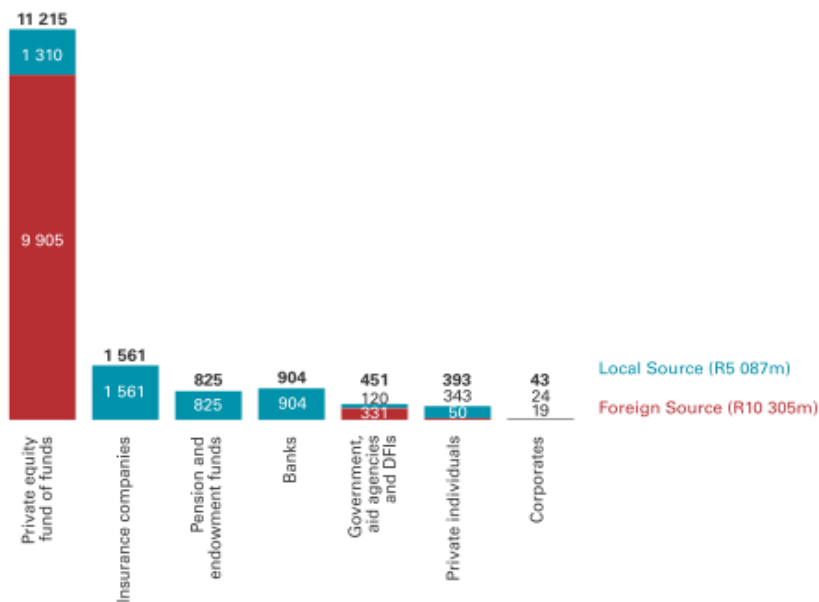


Who invests in PE?

INSTITUTIONS INVESTING IN PE IN SA

Sources of third party funds raised in 2007 (Rm)

Sources of third party funds raised in 2008 (Rm)



- Total third party funds raised declined by 53% in 2008 to R7 227m (2007: R15 392m)
- Most notable was the major change in the composition of investors interested in PE in South Africa, with 39.7% of all third party funds raised during 2008 sourced from Government, aid agencies and DFIs (2007: 2.9%)
- Funds sourced from Private Equity Fund of Funds declined significantly, falling to 21.9% of total third party funding (2007: 78%)