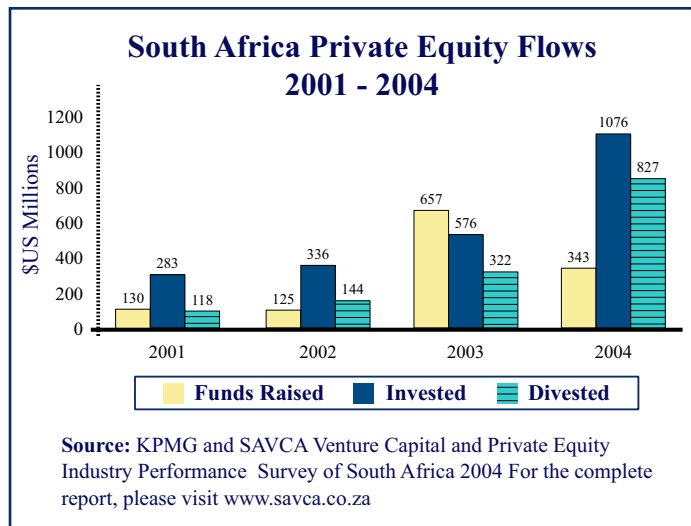


COUNTRY FEATURE: SOUTH AFRICA

Commencing more than ten years ago with the election of Nelson Mandela, South Africa's transformation from global pariah to multi-ethnic democracy has given rise to a vibrant and growing market for private equity. South African private equity offers "the perfect combination," says Andre Roux, CEO of Ethos Private Equity, one of the leading firms in the country. "We have a first class infrastructure for private equity investment within a context of the high return opportunities that can really only be found in emerging markets."

South Africa boasts the 12th largest private equity market in the world¹, with an estimated \$6.6 billion of assets under management and 85 funds.² Most of the capital (62%) is from South African sources, and the majority of the funds are "captive," investing for financial services companies or in some cases for the South African government. But the top firms in the country, including Actis, Brait, and Ethos have drawn the attention of mainstream US and European LPs, who have committed an estimated \$600m to the country since 1999.³ International LPs who have invested in South Africa fund managers include institutional investors such as Axa, CALPERS, Invesco and Harbourvest. Two other Africa-wide funds with international LPs, the AIG African Infrastructure Fund managed by EMP Global and Kingdom Zephyr, also include South Africa within their investment mandate.

Many private equity managers in South Africa give credit to the democratic transition and the policies of the previous Mandela



government and the current president Mbeki's government, for creating the foundation for a vibrant private equity market. John Gnodde, CEO of Brait's private equity business, says "the ANC [African National Congress, the governing party since 1994] has done a terrific job of maintaining fiscal discipline, while bringing about a greater unification of the country. The result has been a transformation of the enabling environment."

"The ANC made the commitment to follow a middle road and to support a real private sector market," says Roelf Meyer, the former Minister of Constitutional Affairs and a negotiator for the National Party at the end of apartheid. "As I look back, it was under apartheid that we suffered most from restrictive economic policy, directed insider deal making, and cronyism... Those evils will always be a challenge, but only under democracy can private markets in general, and private equity in particular, be given the space to thrive."

The macroeconomic picture supports this conclusion. In the mid-1990s, inflation hovered above 10%, but is now 1-3%. Interest rates have declined from the mid-twenties to 10%. Budget deficits have been reduced from 8% in 1994 to a current low of 1.7%, giving the government the leeway for a \$25bn infrastructure investment program. A negative currency reserve position in the late '90s has given way to a \$30bn reserve, which in turn has strengthened the South African Rand. In 1994, the country was rated several notches below investment grade; now South Africa boasts a AA1 Moody's rating.

"The macroeconomic landscape has fundamentally changed," says John Gnodde. "This is not an on-year, off-year kind of cyclical phenomenon." The positive investment environment is leading to a much broader diversification of economic opportunities in a market that was once heavily dominated by the mining sector. In the apartheid era, gold accounted for as much as 45% of exports, but, in 2004, the mining and natural

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South Africa at a Glance 2004

PE Funds Under Mgmt: \$6.59 billion*

PE Funds Raised: \$339 million

PE Funds Invested: \$1.06 billion

PE Investments (% of GDP): 2%

Total Value of Exits: \$817.9 million

Total # of Exits: 130

Population: 42.7 billion

GDP (2004 in USD): \$213.2 billion

GDP Per Capita: \$4,990

2000-04 GDP Av. Growth: 3.4%

GDP Growth 2005: 4%

Exchange rate: 6.48 Rand: 1 USD

Source: Economist, IFC, PWC & KPMG

* As of December 31, 2004 (KPMG) Banco de Brasil, IMF

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resources sector equals only 6% of overall private equity investments. The service sector is the leading category, with 20% of private equity investments, followed by manufacturing with 19%, retail with 16%, information technology with 13%, infrastructure with 11%, and financial services & insurance with 9%.⁴

One factor often mentioned as supporting South Africa's growing private equity market is the high quality of the country's regulatory environment, which is largely modeled on the systems in the UK. "South Africa offers first class standards for corporate governance," says Andre Roux. John Gnodde agrees, adding that the regulatory regime is supported by a judiciary system that has proven its independence.

The democratic transition has also played an important role in deal flow. The political transformation has resulted in the break up of several large conglomerates that were cobbled together under apartheid rules that limited the export of capital. As the capital restrictions loosened and as South Africa became more integrated into global trade, these conglomerates honed their strategies and divested non-core businesses, creating significant deal flow for private equity investors.

More recently, the government-led initiative to recalibrate economic power between white and black, known as Black Economic Empowerment, has created incentives for black investment groups to buy South African companies, often in partnership with established private equity firms. Black Economic Empowerment deals account for an estimated 30% of M&A activity in 2004.

Andre Roux of Ethos points out that "there are more black millionaires now in South Africa than white." Peter Schmid, Managing Partner for the Actis Africa Fund, also sees economic diversification as a driver of opportunity. According to Schmid, "the reality is that a lot of the upside potential lies in the talent one finds in the emerging black entrepreneurial class. Private equity funds would be foolish not to see the upside in taping that market. It can be and should be a win-win situation."

An additional boost to private equity in the country has been the recent growth of the mass consumer market. "There is more and more wealth being gained at lower income levels which is driving a boom in the retail market in South Africa," says John Gnodde. Malcolm Segal, CEO of Sasfin Private Equity and Chair of the South Africa Private Equity and Venture Capital Association (SAVCA), agrees: "South Africa is turning from an economy of five million workers to 42 million workers. This is what is driving South Africa's growth." This growth has

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The Emerging Markets Private Equity Association is now recruiting a Director.

EMPEA also has internship positions available on a semester basis.

For more information about these opportunities, please visit www.empea.net/aboutus/employment.aspx

Top 5 Private Equity Deals in South Africa in 2004

Name of investment	Private equity participant/s	Debt provider/s	Total funding raised (US\$mm)	Type of investment	PE participants' equity interests
Metcash Trading Africa	Nedbank, OMLACSA	Nedbank, Investec, OMSFIN, Absa, Commerzbank	322	MBO	39%
Net1 U.E.P.S. Technologies Inc (Aplitec)	Brait, Southern Cross Capital, FFNP Asset Management		232	Later stage expansion capital	31%
Alexander Forbes	VenFin		181	Replacement capital	25%
Idwala Industrial Holdings	Tiso Private Equity, RMB	RMB, Nedbank, FNB Corporate, Standard Bank	152	LBO	32%
IST	Ethos	Barclays	51	LBO	53%

Source: KPMG and SAVCA Venture Capital and Private Equity Industry Performance Survey of South Africa 2004
 For the complete report, please visit www.savca.co.za

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apparently been picked up in the retail sector where there has been a 200% increase over the last five years in the prices of retail stocks years on the Johannesburg Stock Exchange (JSE).

Private equity fund managers are feeling the wind at their backs. Investments by private equity funds have increased 61% year-on-year. The number of exits by private equity firms has also been increasing year-on-year for the past four years, and in 2004 there were 130 exits in the market.⁵ Trade sales are still the dominant form of exit. One example is an exit from Protea Hospitality Corporation. In 1999, Actis and Comafin had invested \$8 million in Protea, a hotel management chain that was looking to expand its business. Since the investment, Protea developed more than 130 hotels across Africa, the UK and Russia. Actis sold their shares in Protea in July 2005 to a consortium of black investors, generating a reported IRR of 21.5% (US) and a multiple of 2.6 times cash.

There have been seven IPOs on the Johannesburg Stock Exchange (JSE) in the last 18 months, but recent developments do point to an improved climate for private equity backed IPOs. In August of 2005, the private equity firm Brait led a Nasdaq listing of its portfolio company Net1 U.E.P.S Technologies, Inc. Brait, Southern Cone and FFP Asset Management had invested \$150 million in June 2004. The Net1 stock is performing well, up 61% since the IPO. In the coming months, the private equity firm Ethos will be leading a listing of Waco International, a scaffolding company that is experiencing tremendous growth on the back of the country's approximately \$30 billion plans for investment in energy and transportation infrastructure, which are part of the country's preparation for the 2010 World Cup soccer event.

South Africa presents a strong picture of opportunity, but looming over the South Africa story are the grim statistics that document the impact of HIV/AIDs on the population. It is thought that between one-fourth and one-third of working age South Africans are carriers of the disease. The effects of HIV/AIDs on the economy and South Africa's political stability and economic growth are yet to be understood. A second persistent problem is unemployment, which is beginning to improve, but is still high.

Looking forward, another challenge for the South Africa market is increased competition among private equity firms for restructuring deals. According to Peter Schmid of Actis, "auctions are becoming more common, and that is a challenge. Success in my mind will come to those managers who can combine their South Africa investment experience with investing in the rest of the African space and proactively add value."

In addition to geographic expansion, South African private equity may also need to grow at the early stage of the investment cycle. Currently the vast majority of deals are at the

buyout end of the spectrum, with scarce capital at present going to venture and seed investing.

"There is clearly not enough venture capital investing in South Africa," says SAVCA's Malcolm Segal. "Perhaps there is not enough R&D spending to draw innovators to South Africa. There is more that needs to be done in terms of tax incentives to incline people towards venture," he said.

Another key factor for South Africa's success in private equity will be the continuation of sound economic management. It will be important to watch South Africa's political landscape, and there are reasons to think that politics may be more contentious in the coming years. The choice of successors to President Mbeki, who is required by the Constitution to step down after this current term, will be an important signal as to the future direction of the country's economic management.

The ANC has adhered to sound fiscal management through one leadership transition already, and steady economic growth, improvements in service delivery and a resurgent economy are rewarding the ANC's fiscal prudence. Those are positive signs for South Africa's private equity market, but future growth is also going to depend more upon business and investor innovation rather than corporate restructuring. That will be a challenge facing South Africa's entrepreneurs, private equity investors and government policy makers alike.

¹ 2004 Global Private Equity Survey, PWC & 3i.

² KPMG and SAVCA Venture Capital and Private Equity Industry Performance Survey of South Africa 2004, for complete report visit: www.savca.co.za

³ Ibid.

⁴ Ibid.

⁵ Ibid.

Exits: \$12bn Returned to Investors, cont'd from page 4

dynamic should help maintain local interest in the Warsaw stock exchange even if foreign investors retreat.

Another factor that suggests a continued favorable exit environment is the positive prospects for Foreign Direct Investment (FDI) into emerging markets. Recent surveys by the UN Conference on Trade and Development show that the majority of transnational corporations expect FDI to increase over the next three years, and most are picking emerging market destinations such as China, India, Russia, Brazil and Mexico as key targets.⁴

¹ Ernst and Young Global IPO survey 2005, Ernst and Young, May 2005

² "Coming of Age: Global Emerging Markets Liquidity" Deutsche Bank, September 2005

³ *AltAssets*, July 27, 2005

⁴ For full report see <http://www.unctad.org>