

# RisCura - South African Private Equity Performance Report

## *Performance Report*

*As at: 30 June 2015*

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We are pleased to release the June 2015 edition of the RisCura-SAVCA South African Private Equity Performance Report.

This report tracks the performance of a representative basket of South African private equity funds and is published quarterly.

The purpose of the report is to provide stakeholders in South African private equity with insight into industry returns, and to establish and maintain an authoritative benchmark for the measurement of private equity performance in this market. Since its inception in September 2010, this report has become a vital component in the marketing of the private equity industry.

We would like to thank SAVCA members for making their performance data available, and for their commitment to this project.

Rory Ord  
Executive

Erika van der Merwe  
Chief Executive Officer: SAVCA



South Africa, together with other commodity exporting emerging markets has experienced subdued economic growth and currency depreciations in recent months. With preliminary second 2015 quarter on quarter GDP growth figures indicating a contraction of 1.3%, the IMF has revised the 2015 South African GDP growth expectation downward to 1.4% from 2%. The SARB decided to raise the repo rate by 25 basis points to 6% in July, mainly as a result of ZAR depreciation which led to increased inflation expectations. The inflation forecast has deteriorated and expectations are that headline inflation will breach the upper end of the target band, at 6%, in the first quarters of 2016. The main drags on growth remain infrastructure gaps and weak domestic demand. However, increased taxes offset government expenditure and the deficit decreased to 3.4% of GDP.

A major constraint to economic growth in South Africa is uncertainty of electricity supply, with electricity generation levels in 2014 roughly equivalent to those prevalent in 2006 at around 250,000 GWh. As more renewable energy projects come online under the REIPP programme, the 5% of energy production in SA not from Eskom is expected to grow. Medupi's 800MW unit 6 recently began feeding electricity into the grid, which has relieved some of the short term pressure and has gone some way to halting the regular load shedding experienced during much of 2015.

The outlook for South African economic growth for 2015-2017 is weak as continued monetary tightening is expected after the SARB began the rate rising cycle. Weak commodity prices globally have hit many emerging markets, and the IMF estimates that growth is

expected to decrease amongst commodity exporters by 1% annually, compared to 2014 estimates. While South Africa has a relatively well diversified economy, it still has significant direct exposure to resources, and well as secondary exposure through services to this sector, and a large labour reliance on mining jobs. A return to global trend growth over the medium term and a recovery in the commodity cycle will likely see the ZAR stabilising along with economic growth.

The South African private equity market in the second quarter of 2015 had a number of realisations on investments. The trend in realisations is positive in comparison to previous quarters and reflects the current environment of high asset prices, allowing for strong exit prices to be reached. Entry transactions have shown a negative trend over recent periods, as the positive exit conditions also reflect tough entry pricing for new deals.

With the long term outlook for the economy stable but slow, with short to medium term external cyclical risks, the prospects for private equity investments remain relatively positive. Listed equity markets remain highly priced, reducing return expectations and improving the relative case for private equity to offer superior returns. The current report highlights that the returns from private equity funds continue to exhibit strong performance and offer the healthy long-term returns that the industry promises.

Rory Ord  
Executive

Private equity is a long term asset class which differs in nature from most other assets, including listed equity. Typically, private equity fund investments show low correlation to quoted equity markets and are relatively illiquid, particularly in the early years. Private equity will normally show a drop in net asset value before showing any significant gains. This is often the effect of management fees and start-up costs on the relatively small capital base of a new fund.

Private equity funds in South Africa typically follow a commitment and draw down model, which means that investors commit a certain total of capital at the start of a fund, but are only requested to transfer cash to the private equity manager as investments are identified or costs are incurred. These funds typically return capital during the course of the fund's life as investments are realised.

South African private equity offers institutional investors the opportunity to invest in an asset class which has historically outperformed listed equity over the long term. It does, however, have a different nature from quoted equity and it is crucial that an institutional investor considers the appropriateness of private equity to its particular objectives.

### Methods of measuring performance

The most widely accepted method for calculating returns of private equity funds is the annualised internal rate of return (IRR) achieved over a period of time. As a sense check to the IRR measure, we also use the Times Money performance measure. This report measures performance in two ways: by 'since inception' and 'end-to-end' (over three, five and ten years).

### IRR Since inception

This is the most widely used IRR measure of private equity performance. It measures the return of PE funds based on all cash flows in and out of the fund, as well as the remaining net asset value of the fund. This therefore most closely reflects the return an investor would achieve if they invested at the start of the fund. This is the most likely scenario in South Africa where investors in private equity funds are locked in for the life of the fund, and must catch up initial fees when joining a fund after the initial investors.

### End-to-end IRR

End-to-end IRRs allow the computation of the return of groups of private equity funds which do not necessarily have the same inception date. This calculation also allows a better comparison of private equity returns to those of other asset classes over similar periods.

While this method has advantages, it must be noted that it allows the returns of funds at different life cycle stages to be combined. Where the period selected contains more new funds than older funds, the return will likely include a higher balance of fees than a time period with more older funds.

The longer term IRRs are considered to be the most indicative of private equity performance across different stages of the economic cycle, and are considered to be the headline measures. Shorter term returns should be viewed with caution as private equity is a long term investment. However, shorter period returns may be indicative of the general performance of private equity over this short period.

### Times Money

Times Money is the ratio of total capital invested to total capital returned and remaining value. This is a useful cross-check of IRR measures, and is easily understandable. While IRR calculations are heavily dependent on the length of time that capital has been invested, Times Money does not take time into account. A Times Money in excess of 1 means that value has been created for the investor.

### Public market equivalent (PME)

This measure seeks to equate the heavily timing dependent returns of private equity funds with the returns of public market indices. The measure is a ratio of the net outflows from PE funds re-invested into the public index to the end of the fund's life, divided by the inflows into a PE fund invested in the public index until the end of the fund's life. A ratio of above 1 reflects outperformance of private equity, while a ratio under 1 reflects underperformance.



## Performance in South African Rands (ZAR)

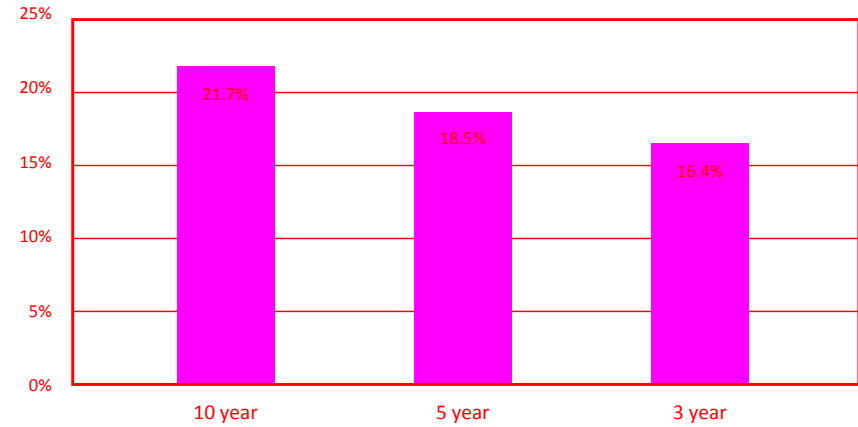
### 5a) Returns over different time periods (ZAR)

We regard the ten year return as the headline measure of private equity returns. This is because of the long-term nature of private equity investments, and the locked-in nature of typical fund structures.

In the private equity context, one year returns are not a reliable measure of performance and have not been presented.

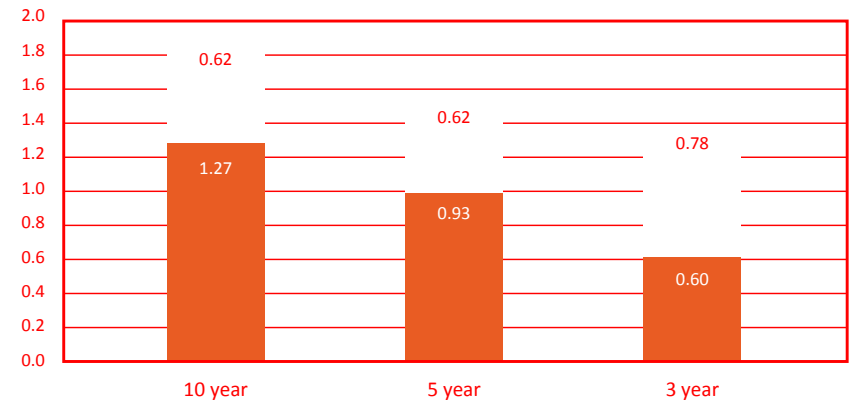
Private Equity Fund Returns (ZAR)				
Year	2010	2011	2012	2013
10 year	21.7%	18.5%	16.4%	
5 year				
3 year				

**Pooled IRR by time period (ZAR)**



◆ Pooled IRR

**Times Money by time period (ZAR)**



◆ Realised Times Money

◆ Unrealised Times Money



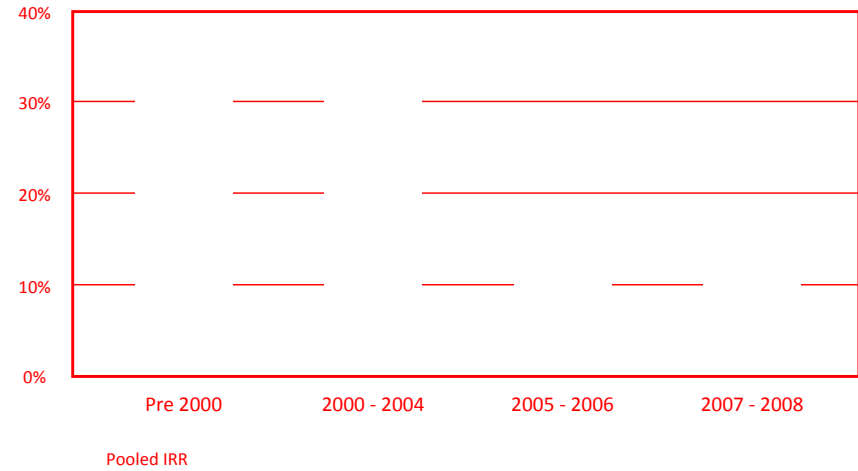
### 5b) Returns by vintage year (ZAR)

Previous studies have shown fund vintage year to be an important determinant of private equity returns. Our findings are consistent with these studies and show a dramatic difference in returns by vintage grouping.

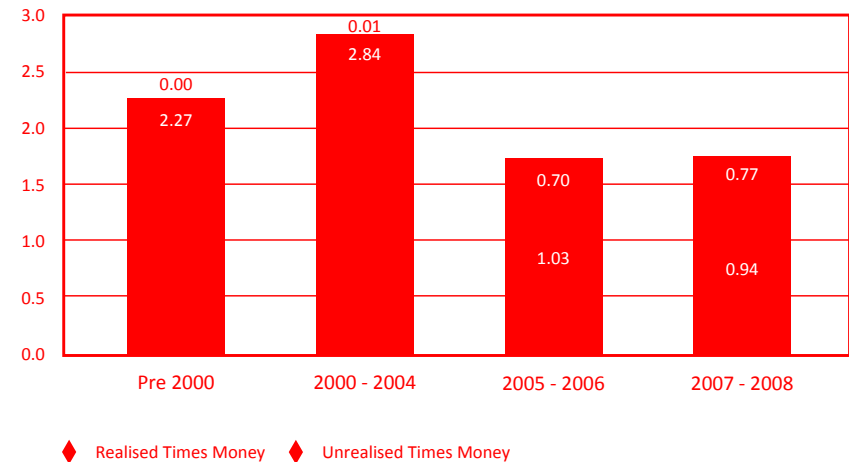
Funds starting in or after 2005 have been negatively impacted by the downturn in the economy. Part of the reason for the poor current results of the most recent vintage grouping is that these funds are still mid-cycle, where management fees still play a significant part in determining fund returns and the investments made by these funds still need to be enhanced by the private equity fund manager.

		Vintage Year		
		Pre 2000	2000 - 2004	2005 - 2008
Number of Funds	Number of Funds	10	10	10
	Number of Funds	10	10	10
	Number of Funds	10	10	10
	Number of Funds	10	10	10
	Number of Funds	10	10	10

### Pooled IRR by vintage year (ZAR)



### Times Money by vintage year (ZAR)



### 5c) Returns by fund size (ZAR)

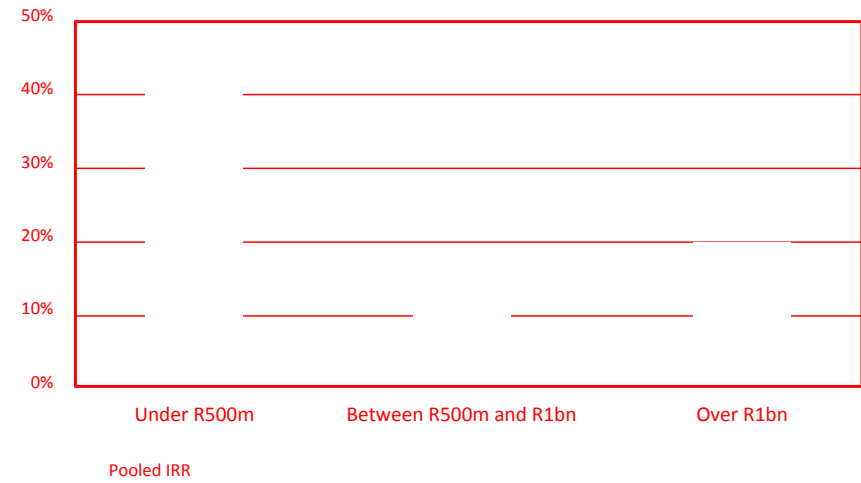
The analysis shows that historically, smaller funds have performed very well. This strong performance may be due to smaller funds investing in the high growth mid-market sized companies that have performed well under generally good economic conditions.

However, it is important to note that the larger funds were more likely to have been in existence more recently, and therefore be part of the poorer vintage year groupings. It is likely that vintage year is a bigger determinant of performance than size.

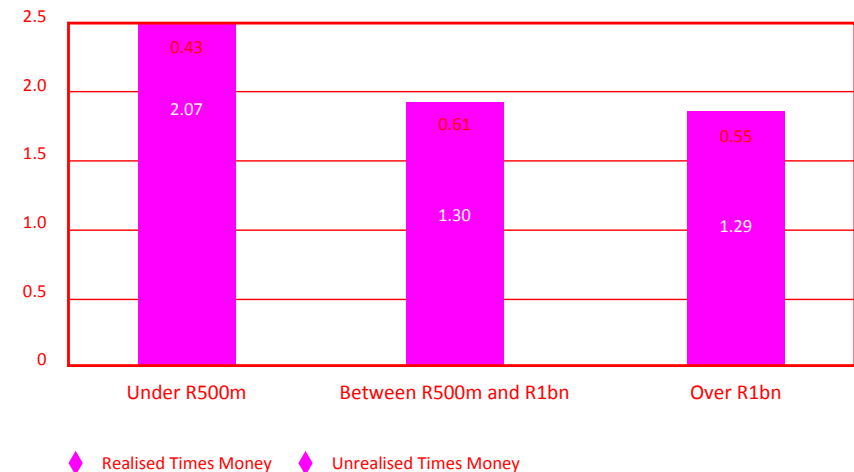
		Fund Size		
		Under R500m	Between R500m and R1bn	Over R1bn
Vintage Year	2007-2008	0.43	0.61	0.55
	2009-2010	2.07	1.30	1.29
	2011-2012	0.43	0.61	0.55
	2013-2014	2.07	1.30	1.29

\*Fund Size is reflected as committed capital in South African Rands.

### Pooled IRR by fund size (ZAR)



### Times Money by fund size (ZAR)



### 5d) Listed equity comparison (ZAR)

IRR returns have been compared to CAGRs of listed indices on a direct basis, and on the more comparable Public Market Equivalent (PME) basis.

Private equity returns compare favourably to the returns of the FTSE/JSE indices over the longer term.

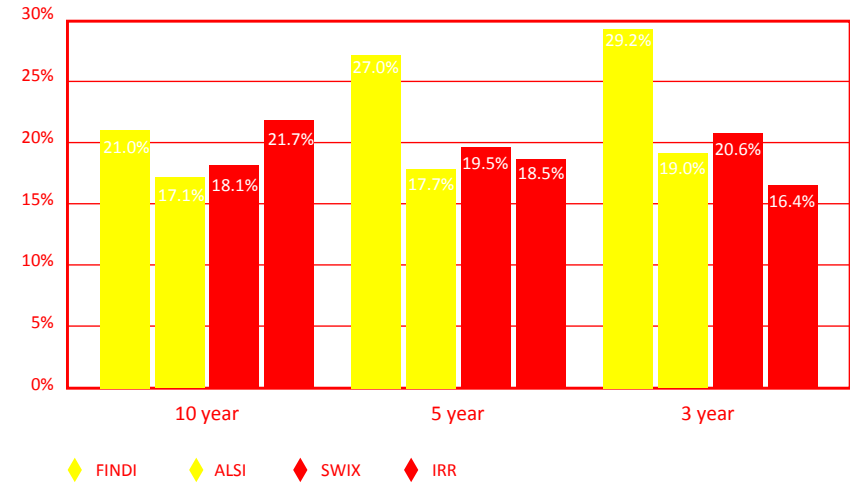
	10 year	5 year	3 year
IRR	21.7%	18.5%	16.4%
FINDI	21.0%	17.7%	19.0%
ALSI	17.1%	19.5%	20.6%
SWIX	18.1%	27.0%	29.2%

	10 year	5 year	3 year
IRR	1.13	0.94	0.89
FINDI	1.05	0.82	0.76
ALSI	1.17	0.97	0.92
SWIX	1.13	0.94	0.89

\*Listed index returns are before fees.

\*\*Listed indices used in the computations are total return indices before fees.

### Pooled IRR compared to listed indices (ZAR)



### Public market equivalent results



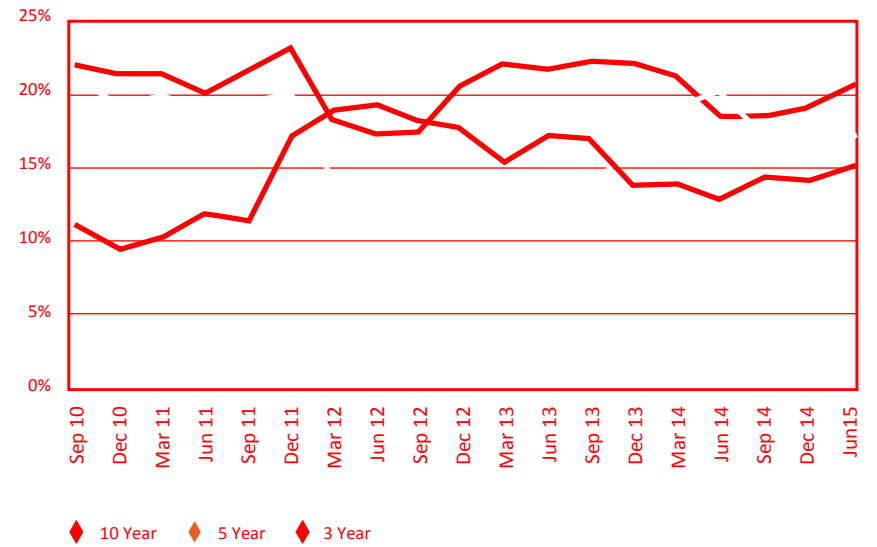
### 5e) Historical returns over different time periods

The table below presents the three, five and ten year returns reported in each quarterly release of the RisCura-SAVCA South African Private Equity Performance Report. This shows how the performance of each term has changed over time.

We regard the ten year return as the headline measure of private equity returns. This is because of the long-term nature of private equity investments, as well as the typical investment cycle of funds which takes some time to realise returns.

Period	10 Year	5 Year	3 Year
Sep 10	10.8%	21.5%	21.5%
Dec 10	9.2%	21.0%	21.0%
Mar 11	9.8%	21.0%	21.0%
Jun 11	11.5%	19.8%	19.8%
Sep 11	11.0%	21.5%	21.5%
Dec 11	16.8%	22.8%	22.8%
Mar 12	17.5%	18.5%	18.5%
Jun 12	16.8%	18.8%	18.8%
Sep 12	17.0%	17.5%	17.5%
Dec 12	17.5%	20.2%	20.2%
Mar 13	15.0%	21.5%	21.5%
Jun 13	16.8%	21.2%	21.2%
Sep 13	16.5%	21.8%	21.8%
Dec 13	13.5%	21.5%	21.5%
Mar 14	13.5%	20.5%	20.5%
Jun 14	12.8%	18.0%	18.0%
Sep 14	14.0%	18.0%	18.0%
Dec 14	13.8%	18.5%	18.5%
Jun 15	14.8%	20.2%	20.2%

Pooled IRR by time period





## Performance in US Dollars (USD)

### 6a) Returns over different time periods (USD)

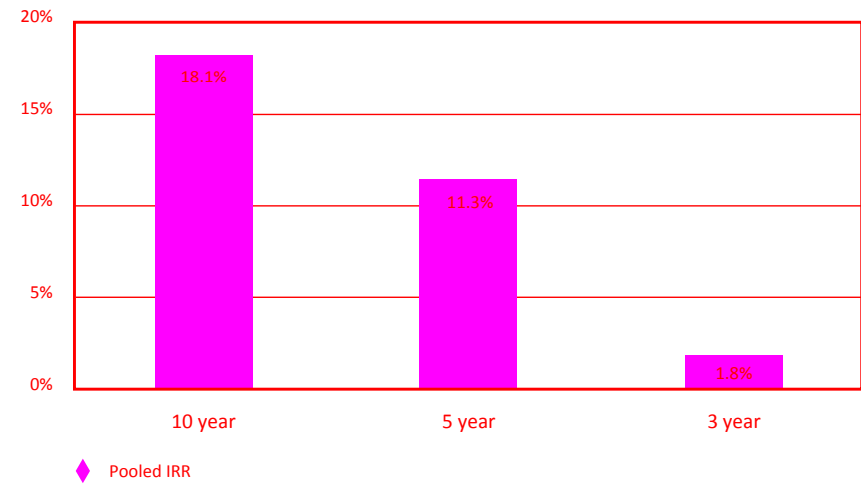
We regard the ten year return as the headline measure of private equity returns. This is because of the long-term nature of private equity investment, and the locked-in nature of typical fund structures.

In the private equity context, one year returns are not a reliable measure of performance and have not been presented.

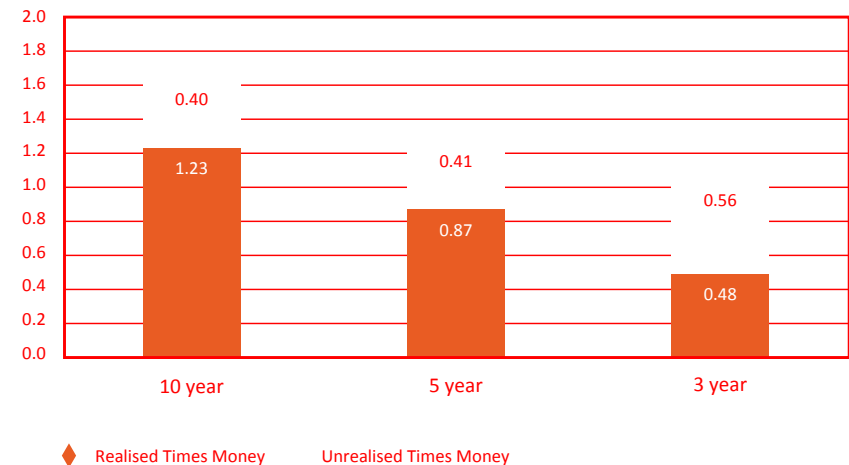
Exchange rate fluctuations have had a large effect on 3 year returns as a result of the steady depreciation of the ZAR over the 3 year period.

Pooled IRR by time period (USD)				
Time Period	Realised IRR	Unrealised IRR	Total IRR	Standard Deviation
10 year	18.1%	11.3%	29.4%	1.8%
5 year	11.3%	1.8%	13.1%	1.8%
3 year	1.8%	1.8%	3.6%	1.8%

Pooled IRR by time period (USD)



Times Money by time period (USD)



### 6b) Returns by vintage year (USD)

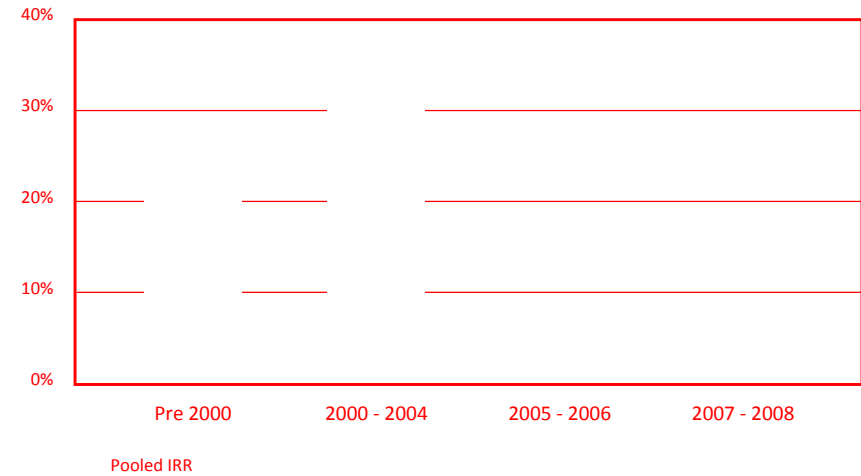
Previous studies have shown fund vintage year to be an important determinant of private equity returns. Our findings are consistent with these studies, and show a dramatic difference in returns by vintage grouping.

At 36.5%, the 2000 to 2004 vintage year grouping was the best of the vintage groups surveyed. This time period matches a period of strong growth in the South African economy, as well as strong growth on the Johannesburg Stock Exchange.

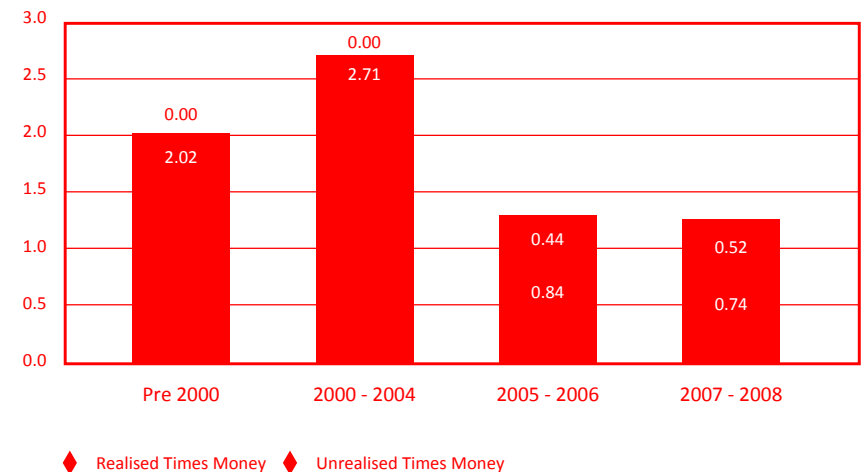
The more recent vintages have been more negatively affected by the Rand:Dollar exchange rate.

		Pooled IRR		
		Pre 2000	2000 - 2004	2005 - 2008
Realised	2000 - 2004	10.00%	36.50%	10.00%
Unrealised	2000 - 2004	10.00%	36.50%	10.00%
Realised	2005 - 2008	10.00%	36.50%	10.00%
Unrealised	2005 - 2008	10.00%	36.50%	10.00%
Realised	Pre 2000	10.00%	36.50%	10.00%
Unrealised	Pre 2000	10.00%	36.50%	10.00%

### Pooled IRR by vintage year (USD)



### Times Money by vintage year (USD)



### 6c) Returns by fund size (USD)

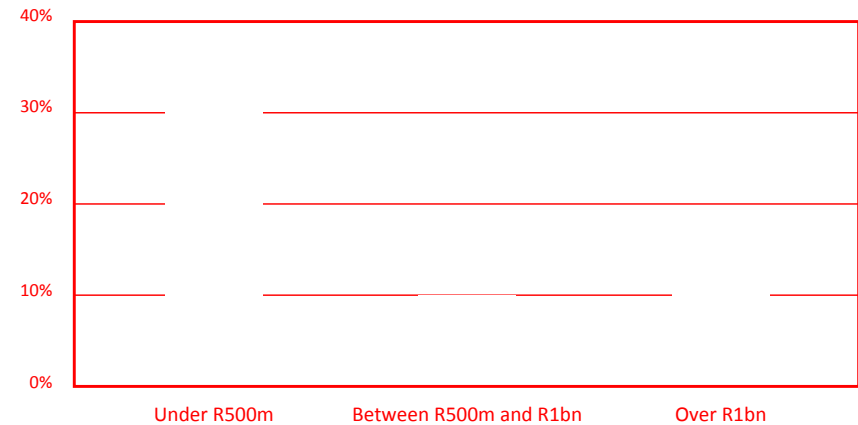
The analysis shows that historically, smaller funds have performed very well. This strong performance may be due to smaller funds investing in the high growth mid-market sized companies that have performed well under generally good economic conditions.

However, it is important to note that the larger funds were more likely to have been in existence more recently, and therefore be part of the poorer vintage year groupings. It is likely that vintage year is a bigger determinant of performance than size.

		Fund Size (USD)		
		Under R500m	Between R500m and R1bn	Over R1bn
Vintage Year	2007-2009	0.22	1.94	0.35
	2010-2012	0.34	1.09	1.27
	2013-2014	0.22	1.94	0.35
	2015	0.34	1.09	1.27

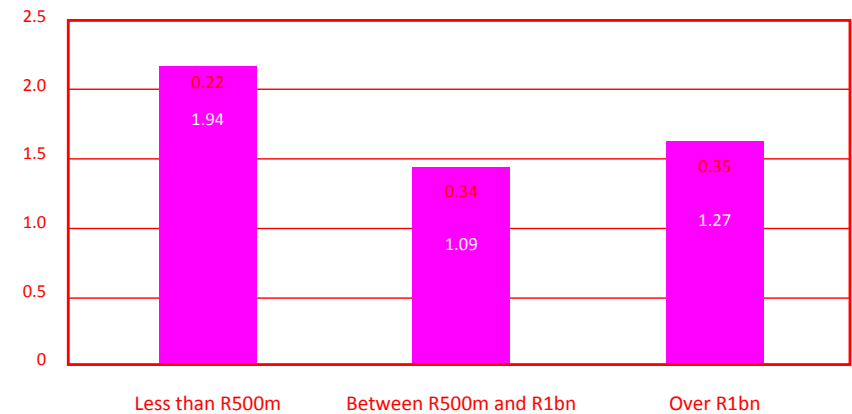
\*Fund Size is reflected as committed capital in South African Rands.

### Pooled IRR by fund size (USD)



Pooled IRR

### Times Money by fund size (USD)



◆ Realised Times Money ◆ Unrealised Times Money



**Users of this report may find the following information useful:**

- Returns of cash flow and portfolio value data from private equity managers are the primary source for information included in this Report.
- The IRR performance calculation solves for the discount rate that makes the Net Present Value of a set of cash flows equal to zero. The calculation is based on cash-on-cash returns over equal periods, modified for the residual value of the fund's equity (NAV). The residual value attributed to each respective group being measured is incorporated as its ending value.
- The database accounts for cash flows on a daily basis wherever possible otherwise a monthly basis, and NAVs on a quarterly basis.
- The End-to-End performance calculation is similar to the since inception IRR, however, it is measuring the return between two points in time. The calculation takes into account the opening NAV, the in-period cash flows and the closing NAV. Returns are then annualised for comparability.
- The pool of funds has been split into subsets where this would enhance the user's understanding of returns. However, this has been balanced with confidentiality considerations, and no such subsets include fewer than four funds.
- Most funds included in this Report have unrealised investments, and therefore rely on the valuation of these investments to determine returns. All participating fund managers are members of SAVCA and apply the International Private Equity and Venture Capital Valuation Guidelines to determine these valuations. RisCura has not verified that these Guidelines have been adhered to.
- Only South African Rand denominated funds have been included in this Report, and therefore none of the returns included are affected by exchange rate movements. Returns in USD have been presented for comparability with other markets.

**CAGR** is the cumulative annual growth rate.

**Committed capital** is the value of dedicated investment funds pledged by the investors of a private equity fund and available for investment. This is a proxy for the size of the fund.

**Fund Size** is determined by the committed capital of a fund.

**IRRs** are money-weighted returns that should be compared to time-weighted returns with caution. Time-weighted returns are used to measure returns in most asset classes where frequent valuations are available.

**PME** Public Market Equivalent is a measure that determines whether private equity returns have exceeded or underperformed a public market. A PME score of more than one indicates outperformance of private equity.

**Pooled IRR** aggregates or "pools" all cash flows and ending NAVs to calculate a money-weighted return.

**Realised Times Money** is the multiple of cash returned to investors divided by total cash invested.

**Total Times Money** is the sum of the Realised and Unrealised Times Money.

**Unrealised Times Money** is the multiple of the carrying value of portfolio investments not yet returned to investors divided by total cash invested.

**Vintage Year** is defined as the year in which a fund first draws down capital from its investors.

RisCura Fundamentals is the leading provider of independent valuation, risk and performance analysis services to investors in unlisted instruments in Africa. We work in partnership with our clients to deliver the transparency and accountability that increasingly is demanded by investors and auditors. Our clients include private equity funds, pension funds, credit funds, banks and other investors in Africa, and cover industries as diverse as agriculture, retail, manufacturing and the extractive industries.

**For more information about our services please contact Rory Ord on +27 21 673 6999 or [rord@riscura.com](mailto:rord@riscura.com).**

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RIS

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