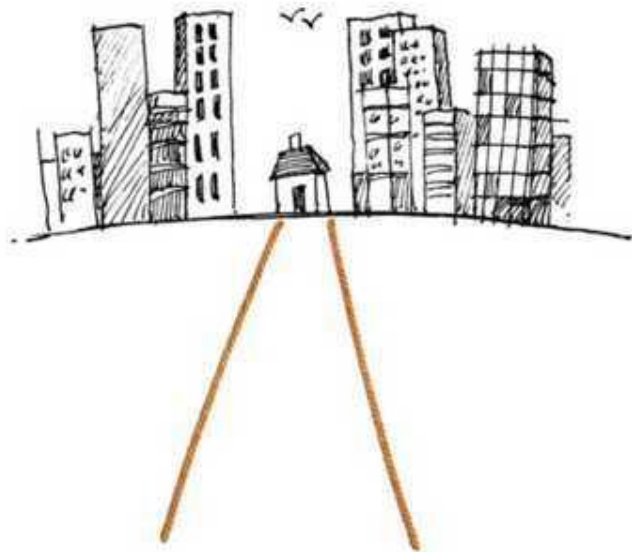




Introduction to Private Equity



Straight advice from an independent perspective.

February 2013

We will be looking at...



- 1 What is Private Equity?
- 2 Private Equity Strategies
- 3 Risk and Return
- 4 Why Do Pension Funds Invest in PE?

What is Private Equity? A comparison

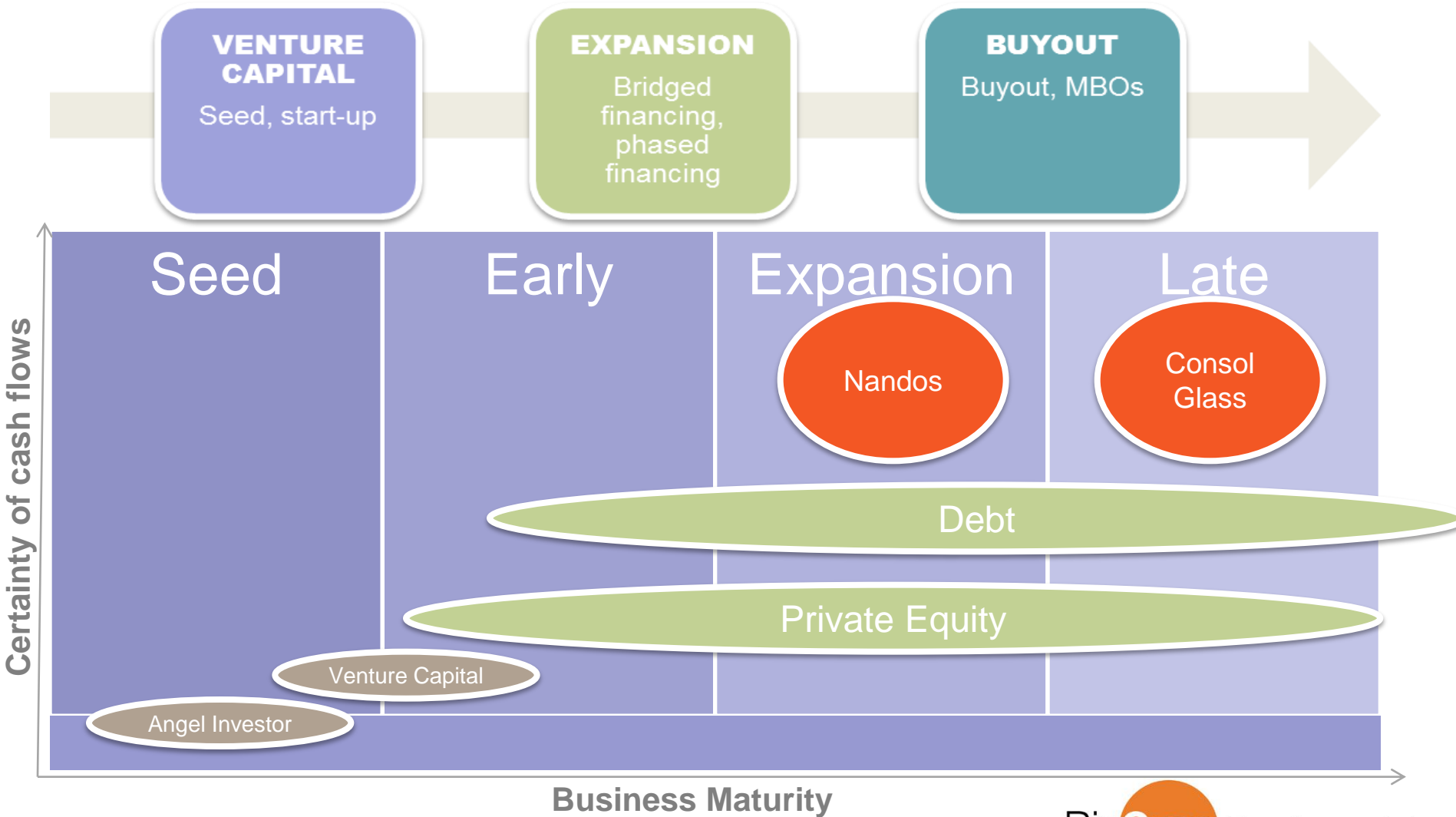
PRIVATE EQUITY

- 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

Stages of Funding



Why Do Companies Seek PE Funding?

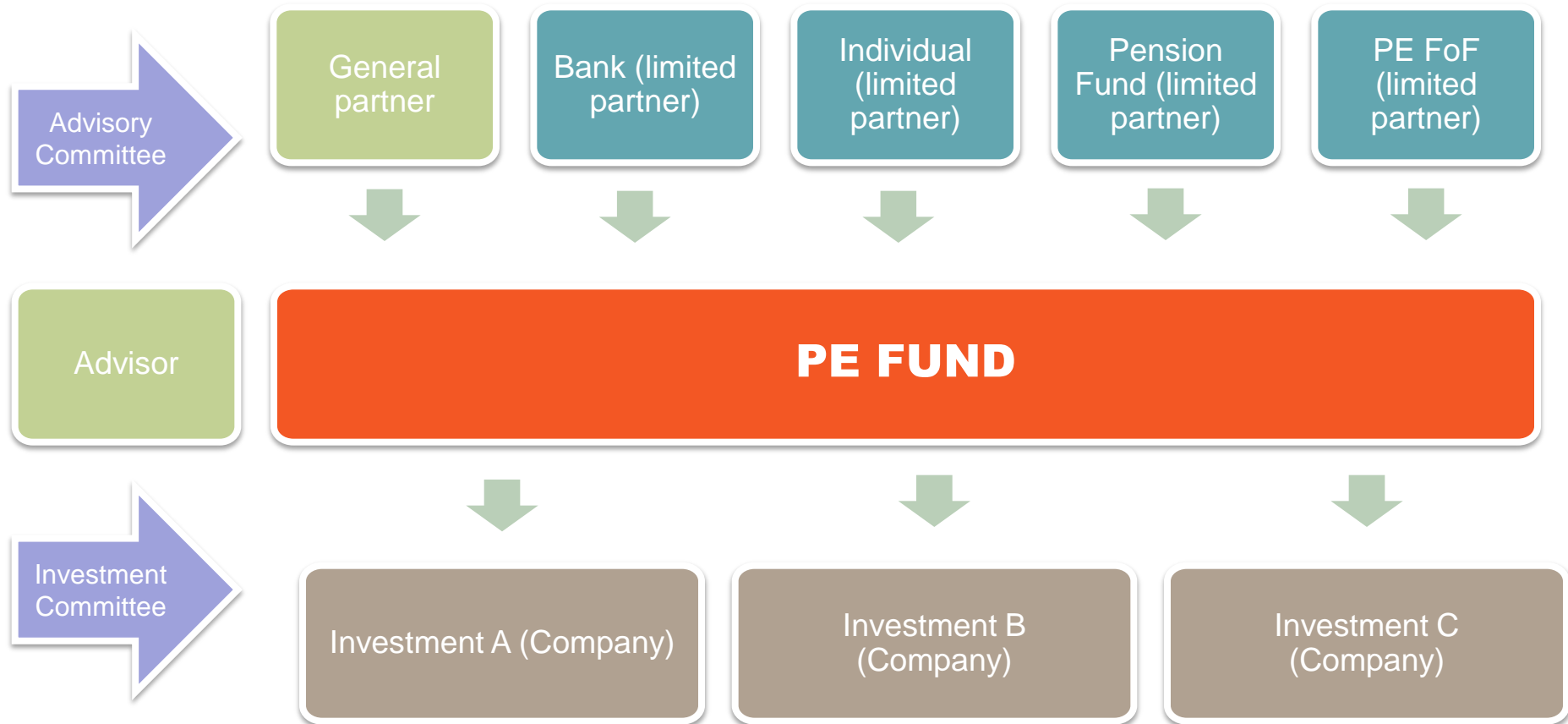


PE vs. Debt Financing

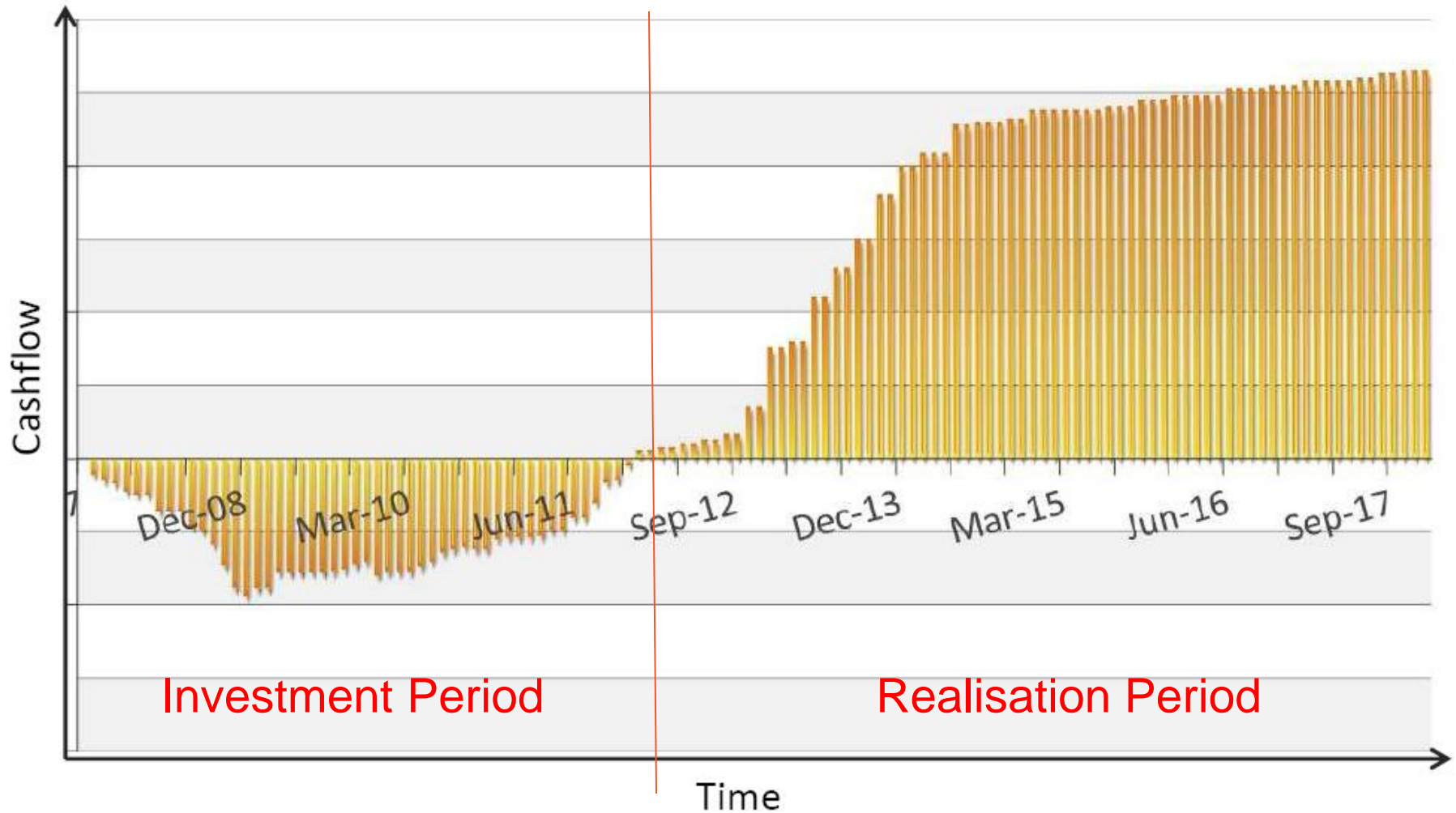
- Not every business suits debt funding
- Balance of debt and equity needed
- Experienced professionals
- Political / corporate Connections
- GP's have experience in sector / stage of business

Non Monetary Benefit

Structure and roles of LPs and GPs

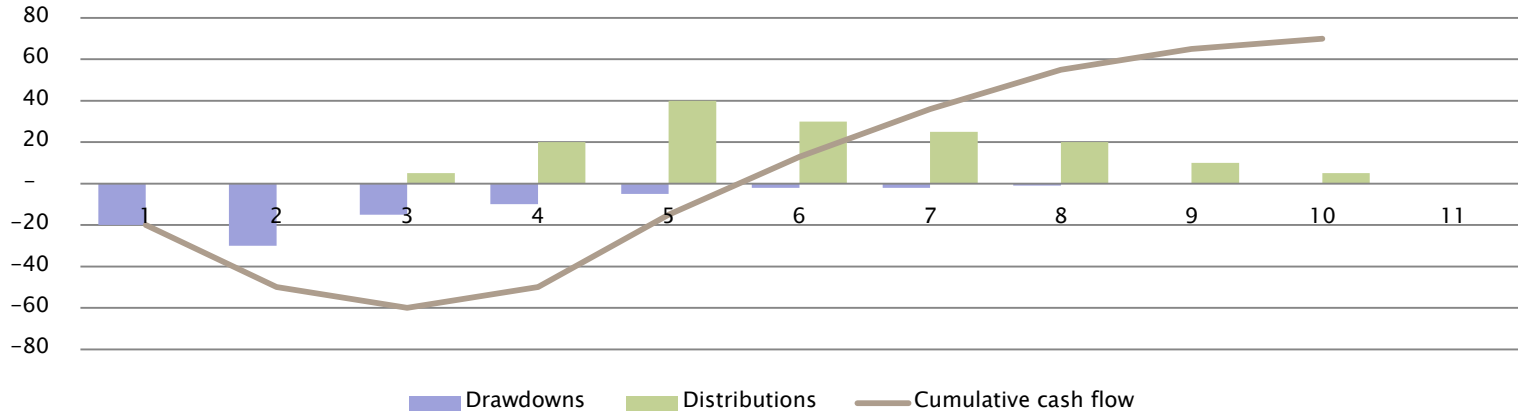


Commitments vs. Drawdowns

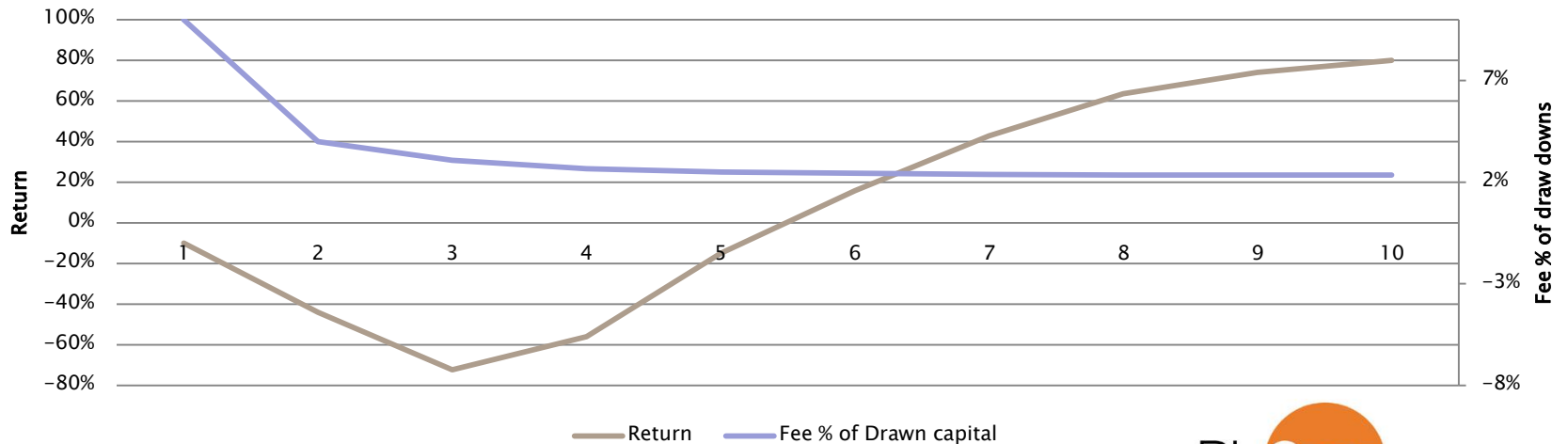


Understanding the J-curve

Cash flow J-curve



Returns J-Curve



Where Does a Company's Value Come From?



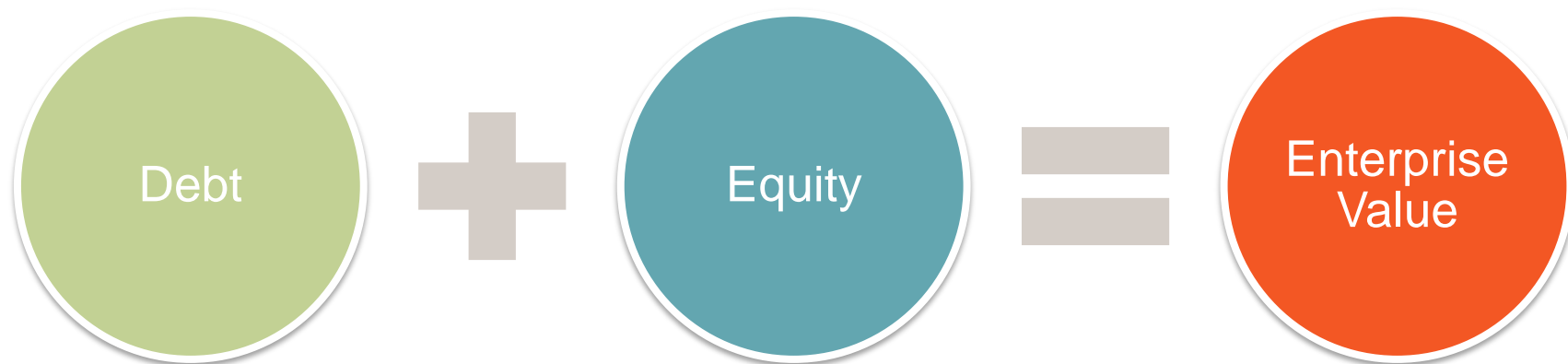
Financial Performance

Sales	100
Cost of sales	(60)
Gross profit	40
Overheads	(25)
Operating profit (EBITDA)	15

Company Valuation

EBITDA	15
EBITDA Multiple	X 6
Enterprise value	90

Where Does the Value Go?



Low debt (leverage)			
Debt	10	10	0%
Equity	80	90	13%
Enterprise Value	90	100	11%

Higher debt (leverage)			
Debt	50	50	0%
Equity	40	50	25%
Enterprise Value	90	100	11%

Debt and Equity Risk and Return

	Return	Risk
Debt	Return limited to interest rate	Low risk All equity must be eroded before any loss for debt
Equity	Unlimited upside	More risky than debt Takes the first losses of value The more debt there is, the more risky the equity

- As long as returns on debt taken on exceed the interest rate on the debt, equity returns are enhanced
- But there are limits – ratio of Debt : EBITDA is common (2-3 times is normal)

Fee Structure

Single Fund

Fund of Funds

2% advisory fee

1% advisory fee

Advisory fee – an annual payment is made by the fund to the Advisor to cover the costs of the private equity firm's investment operations (the fee is typically 1% to 2.5% of the aggregate committed capital of the fund)

A participation in the gains and surpluses up to 20%

A participation in the gains and surpluses up to 10%

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 return. The remaining 80% of the gains and surpluses is paid to the investors pro rata to their capital

Hurdle rate or preferred return – a minimum rate of return (normally 8% to 12%) earned by investors on their committed capital must be achieved before the General Partner or Trustee can receive its participation in the gains and surpluses

SA Private Equity has Outperformed

Public market equivalent results

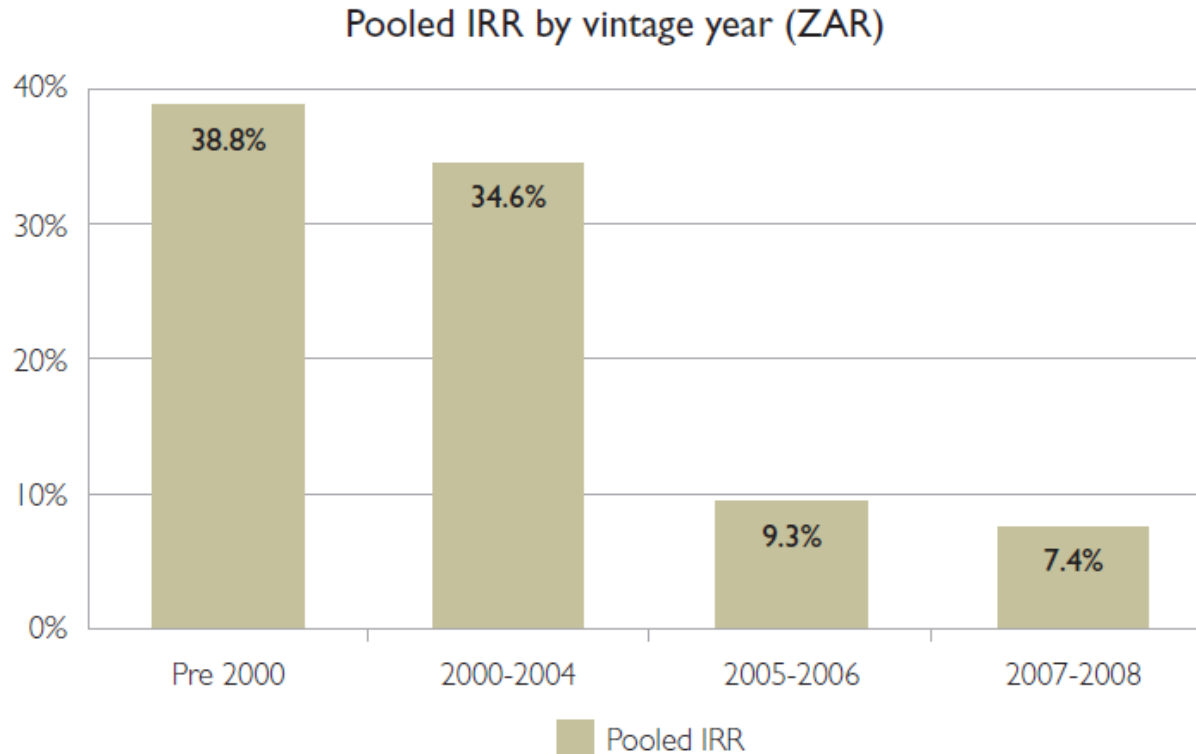


SA private equity has largely outperformed the major listed indices

FINDI tests resources bias of JSE

SWIX tests market cap vs. tradability bias - less than 10 years old

Vintage Year Performance

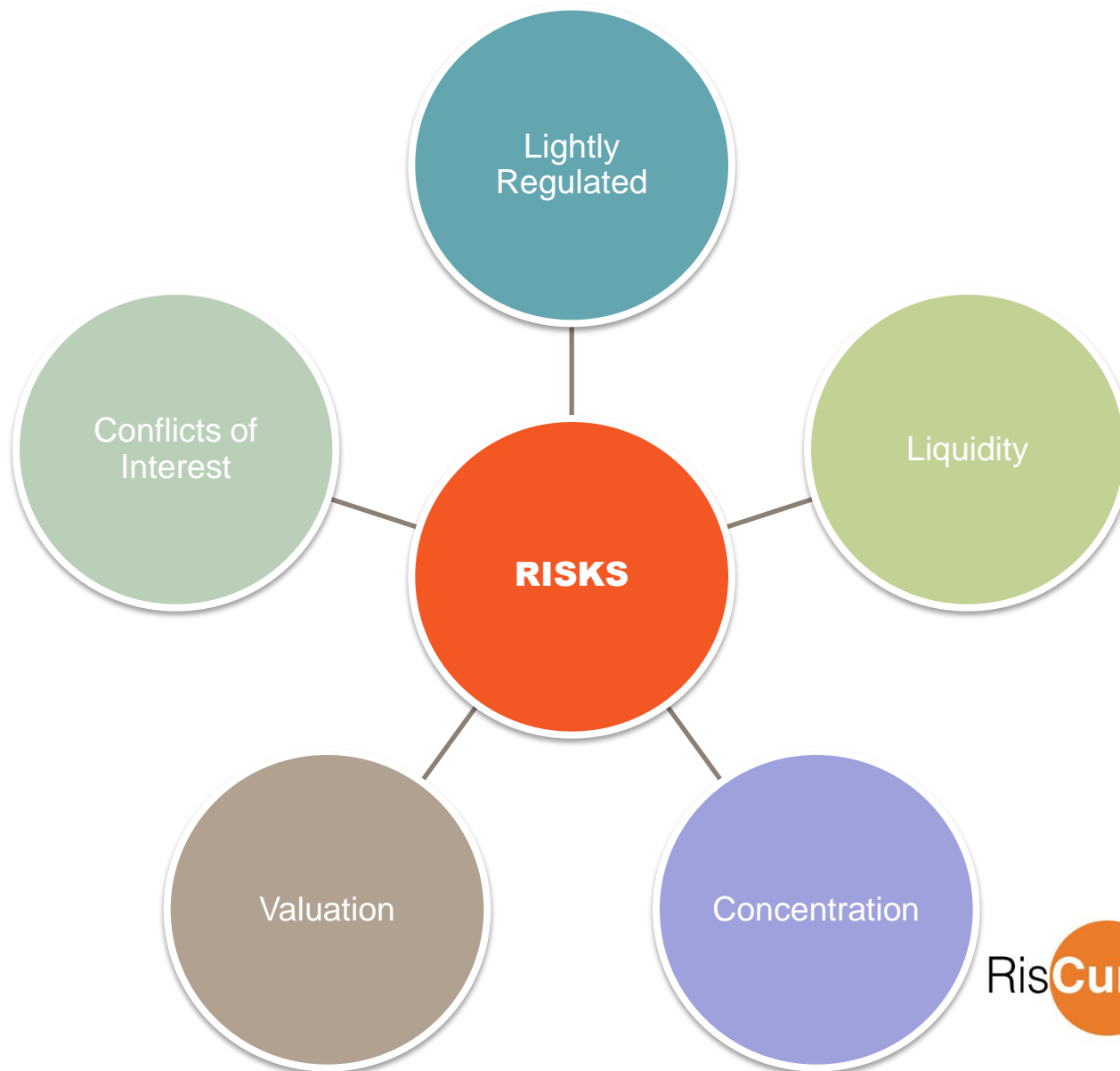


Older vintages have performed better

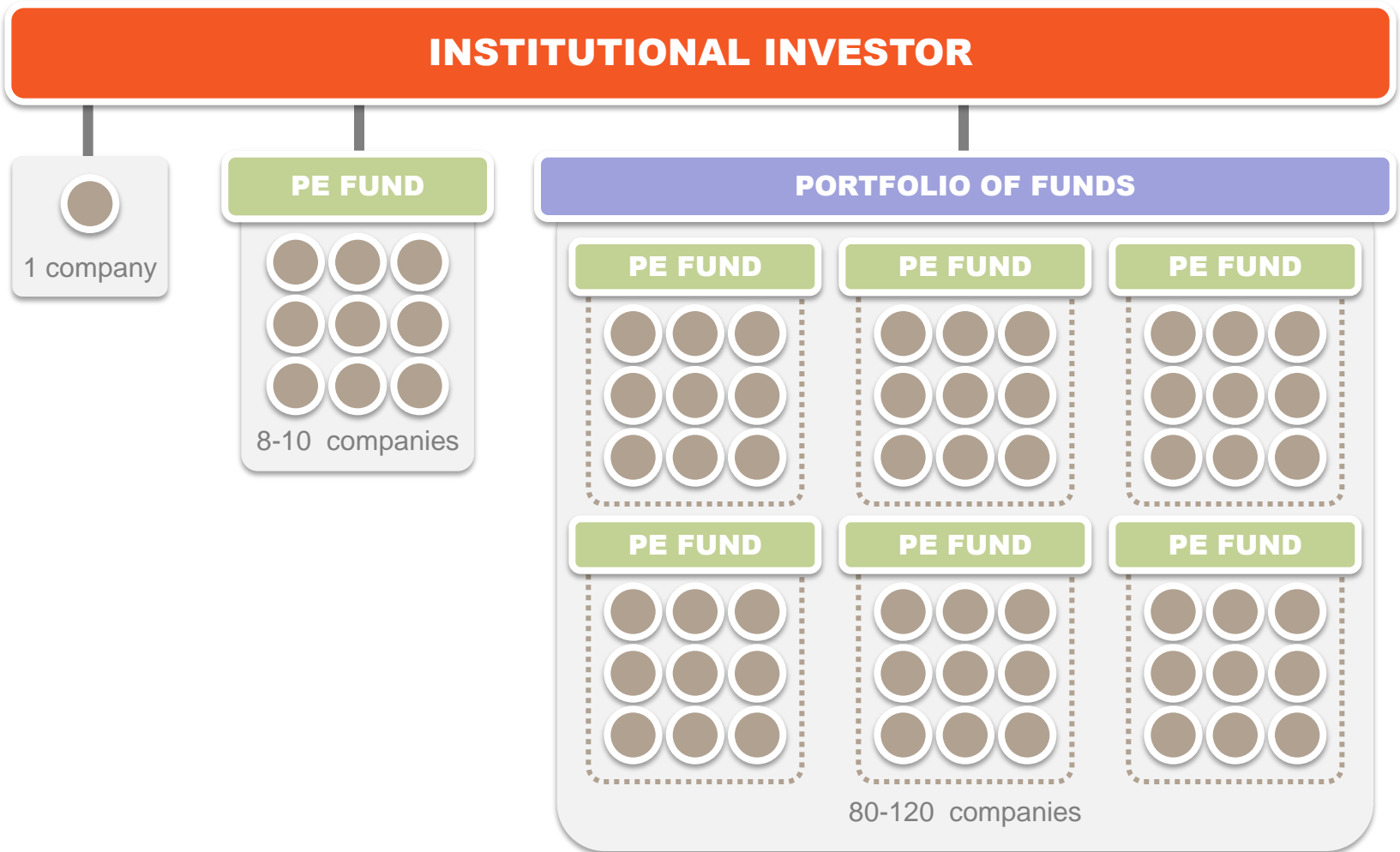
Newer vintages are largely unrealised

All vintages show positive returns

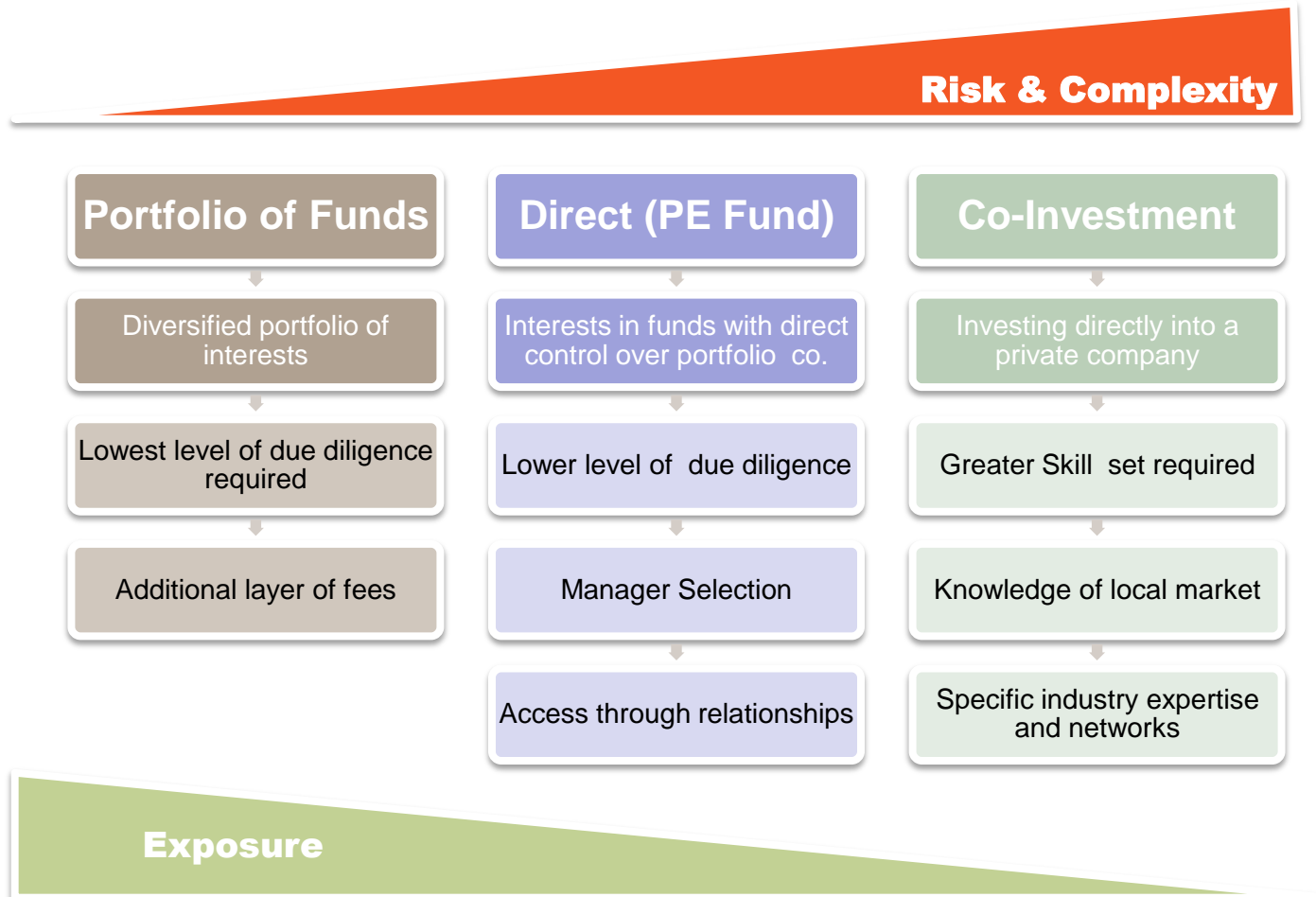
What Are the Risks of Private Equity?



Ways to Invest in Private Equity



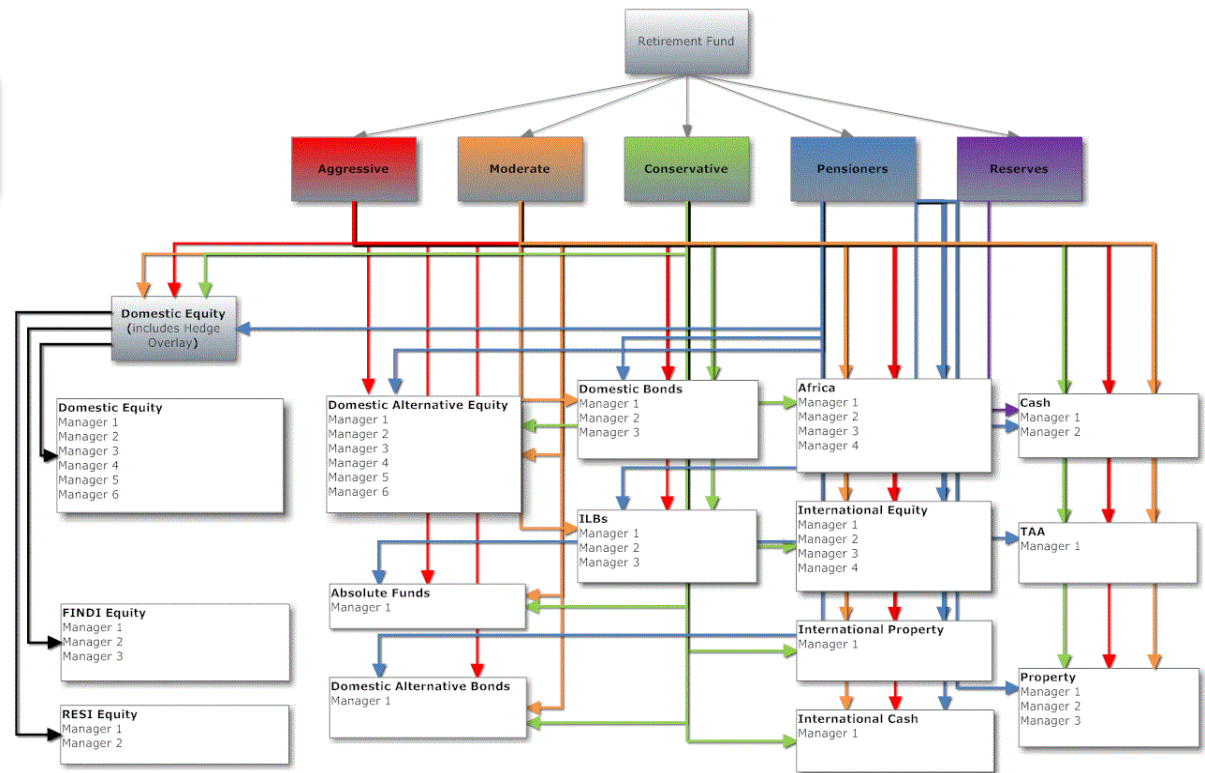
Building a Private Equity Portfolio



Asset Allocation Decision

IS PE THE RIGHT ASSET CLASS FOR YOU?

- Historic performance
- Risks may impact returns
- Micro/macroeconomic
- Regulation
- Diversification benefits
- Developmental impact



Why Do Pension Funds Invest in PE?

“Long-term savings vehicles, such as pension funds, are uniquely positioned to manage the long investment term and limited liquidity of private equity investment to capture what appears to be a significant performance premium and diversification benefits.”

- *“Is Private Equity a suitable investment for South African Pension Funds?”*

released at the Convention of the Actuarial Society of South African in October 2006

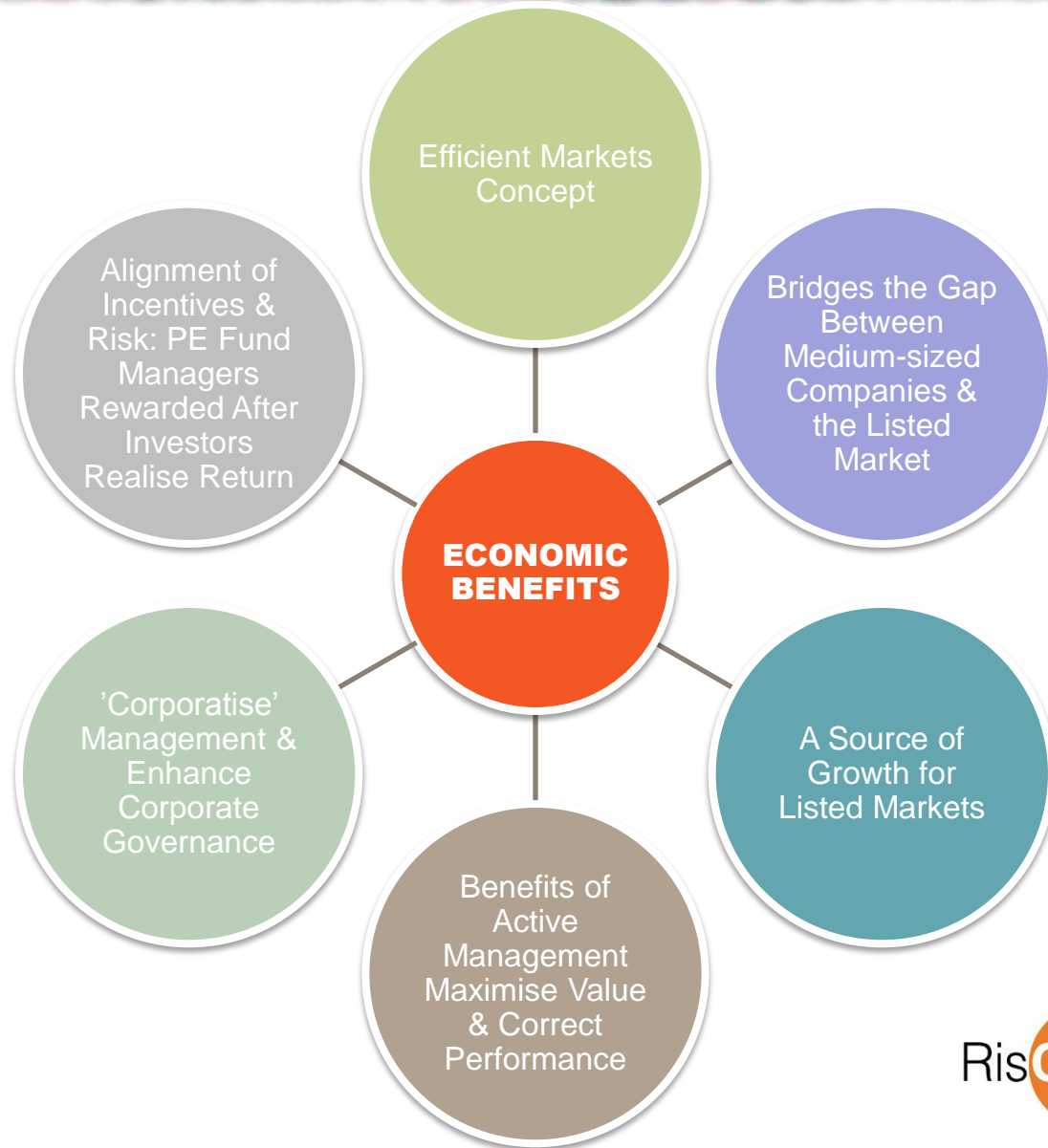
PORTFOLIO OPTIMISATION

- Performance premium to listed equity
- Low correlation to listed equity (although becoming more correlated)
- Exposure to small and medium sized companies

DEVELOPMENTAL VEHICLE

- Facilitation ownership by company staff
- Provides finance and expertise to unlisted companies
- Improves governance

Many Other Benefits to Private Equity



What is Happening in Developed Markets?

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 to Manage Risk as an Investor into PE

1ST ASSET ALLOCATION DECISION

- Should an allocation be made to PE?
- Historic performance
- Risk
- Regulation
- Diversification
- Geography
 - Local
 - Regional
 - Global

2ND MANAGER SELECTION DECISION

- Has the manager run a previous successful fund?
- Manager reputation
- Manager network
- Risk management processes

3RD FUND SELECTION

- What is the fund going to invest in?
- Legal & tax structuring
- Fee structure – alignment of interests
- Quality of advisors
- Reporting requirements
- Mandate fit
- Who are the other investors?
- Essentially a due diligence process

4TH ONGOING MONITORING

- Performance analysis
- Independent valuation
- Regular interaction with managers

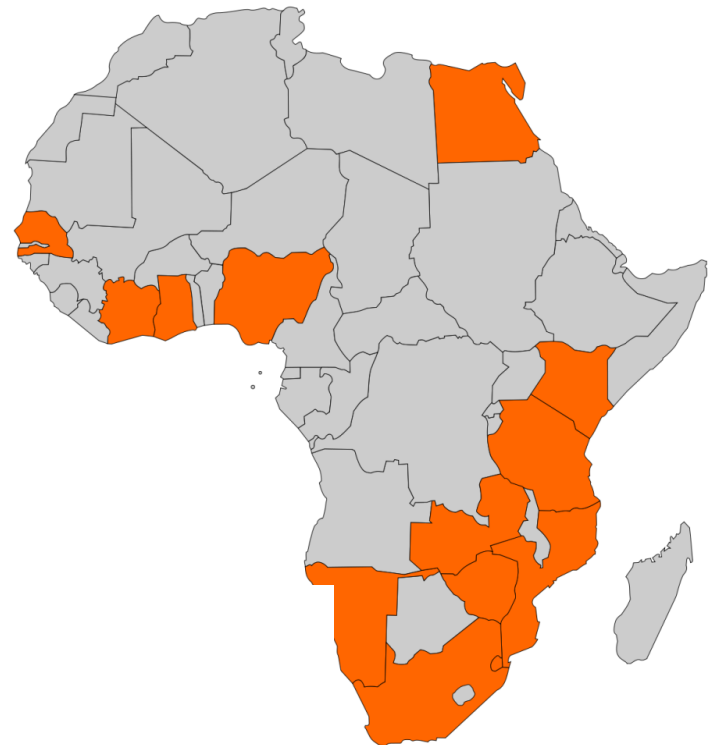


Thank you

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