

Southern African Venture Capital & Private Equity Association

2012 SAVCA Venture Solutions VC survey

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For and on behalf of
The Southern African Venture Capital and Private Equity Association (SAVCA)



September 2012



Notable results from the SAVCA Venture Solutions 2012 VC survey

11 funds surveyed recording 103 venture capital (VC) transactions (2009 to July 2012).

R 0,83 billion invested in the venture capital asset class (2009 to July 2012)*.

46% of transactions executed by private venture capital fund managers and 51% of transactions executed by government backed venture capital fund managers.

37% of deals in start-up capital.

35% of deals in information, communication and technology (ICT) and electronics.

25% of transactions in life sciences (biotechnology, medical devices, health technology).

Gauteng is the largest base for venture capital transactions but Cape Town received more venture capital funds than either Johannesburg or Pretoria.

12 full exits and 4 partial exits were made in the survey period.

Notable developments include:

- VISA's US\$ 110 million acquisition of Cape Town based, South African VC funded Fundamo.
- Successful angel investments facilitated by the newly formed Angel Hub as an intervention to stimulate an increase in early stage high-growth investments.
- The launch of new funds during the survey period, including the set-up of local offices for international players such as Omidyar Network, Google's Umbono, and Enterprise Development backed initiatives such as the SAB Foundation, Anglo Zimele and Edge Growth Social Investment Fund.
- Further improvement of National Treasury's tax incentive for venture capital, aimed to draw more individual and corporate investment in the VC asset class.



* Real figure may be as much as double the stated figure, considering that many deals that were concluded, but not disclosed to SAVCA, thus not included in the above figures, such as deals from corporate venturing, enterprise development activities, business partners and Angel investors.



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SAVCA and Venture Solutions would like to thank the fund managers for contributing to this survey.



Venture capital (VC) and funding of early-stage high-growth ventures is an important feature of any developing economy such as South Africa. The VC asset class, a subset of the R120 billion private equity asset class in South Africa, generally refers to funding (predominately equity or mezzanine funding) of high growth potential businesses, whose growth potential is typically achieved through radical global scaling, and which normally have technological or other innovative concepts at their core.

In 2010, SAVCA commissioned a review of all VC activity in the previous ten years based on our belief that an adequately large body of empirical evidence had developed in South Africa making possible a comprehensive and useful analysis of VC activity. The 2010 survey results pointed towards a significant, albeit emergent VC asset class in South Africa.

SAVCA and Venture Solutions have now conducted this follow-up survey, reviewing activity between 1 January 2009 and 30 June 2012.

I am proud to announce the completion of the survey and the formulation of the results into the 2012 SAVCA Venture Solutions VC survey, reported on in this document. It not only builds on the holistic

overview from the 2010 survey, but also offers a platform from which to achieve the following:

- Expand the understanding of the structural strengths and weaknesses of the SA VC ecosystem;
- Provide strategic guidance to VC fund managers, government agencies such as the DTI and the Technology Innovation Agency (TIA); and
- Provide empirical proof to South African investors that VC is an attractive asset class in which to invest.

SAVCA again partnered with Venture Solutions, a South African innovation management and commercialisation consultancy, to conduct this survey.

The survey output has been structured to report on aggregate data, trend analysis and recommendations and not to cast a specific light on individual investors or fund managers, but rather to offer an overview of the industry.

Our grateful thanks are extended to Venture Solutions and all who supported the survey.

Malcolm Segal
Executive Consultant
SAVCA
21 September 2012



1. Objectives and methodology

The primary objectives of the analysis included defining the venture capital and early-stage asset class in South Africa by building on the 2000-2010 data and market info for the survey. The survey considered the calendar years between 2009 and 2011, as well as transactions conducted in the first half of 2012, using data gathered through questionnaires and interviews with venture capital funders and other investors that conducted venture capital type investments.

The approach to the survey, similar to that used in 2010, was to employ a bottom-up view by collecting and reviewing verifiable information about venture capital transactions actually concluded. In doing so, the survey utilised a solid platform from which to build a holistic view for industry-wide analysis.

Information about transactions and the fund managers/operators, was gathered through a combination of sources, including information available in the

media about transactions concluded, one-on-one interviews with venture capital fund managers and related stakeholders, and additional referrals from stakeholder interviews.

This allowed for a comprehensive overview of activities based on actual investment information, spread annually over the full period of the review, and allowing for further analysis of trends, deal characteristics, and fund manager attributes and preferences.

It is important to keep in mind that the purpose of the second SAVCA Venture Solutions Venture Capital survey is to create an holistic view of the extent of venture capital activity in South Africa, defining the asset class as a whole.

The approach to this review is therefore not judgemental, with no disclosure of per-company information and/or contributions.

2. SAVCA definitions and defined stages of venture capital

For the purpose of this survey, the SAVCA venture capital working group definitions were adopted, with venture capital defined as...

A subset of the private equity asset class which deals with predominantly equity funding of high tech, high growth-potential businesses, whose growth is typically achieved through radical global scaling.

The need for venture capital stems from the specific requirements of

such businesses in the start-up and early growth phases, and the part that experienced venture capital fund managers can play in structuring and nurturing investments into these businesses.

The following four stages of venture capital were considered for the survey:

Seed funding: The initial capital used to start a business. Seed capital often comes from the company founders' personal assets or from friends and family.



The state of venture capital in South Africa

Seed money is typically used to pay for preliminary operations as market research and product development. Seed funding is not normally associated with the venture capital fund managers, especially not in South Africa.

Start-up capital: Early funding used for setting up operations (hiring staff, renting office space, equipping the production system, etc.), commercialising intellectual property, and other activities.

Development capital (mostly pre-revenue deals): Finance used after start-up capital to further launch the business and grow market share in order to become profitable.

Growth capital (post-revenue deals): Equity type investments used to assist established but still high-risk ventures in expanding activity such as launching into foreign markets, creating new product/technology lines, accelerating production and/or acquiring competitors.

3. Survey scope and attributes

A comprehensive survey questionnaire was developed, probing a large number of attributes about:

- Venture capital funds (fund origin, ownership, contributions, location, structure, portfolio details, etc.);
- Venture capital fund managers (team, location, mandate, source of funds, funds under management, management fees, experience, fund raising activities, deal flow and investment history, exit strategy and history, etc.); and
- Suggestions as to the development and future of the venture capital asset class in South Africa.

Venture capital in South Africa is still an emergent asset class and not all investors, especially those not operating as venture capital fund managers (e.g. private investors, corporations, not-for-profits), have the processes and systems with which to record and make available all the information required for a full review of the asset class.

Despite this, the data analysis aimed to identify attributes with as much complete information as possible, so as to enable verifiable and informative analysis and reporting.

4. Information excluded from survey data

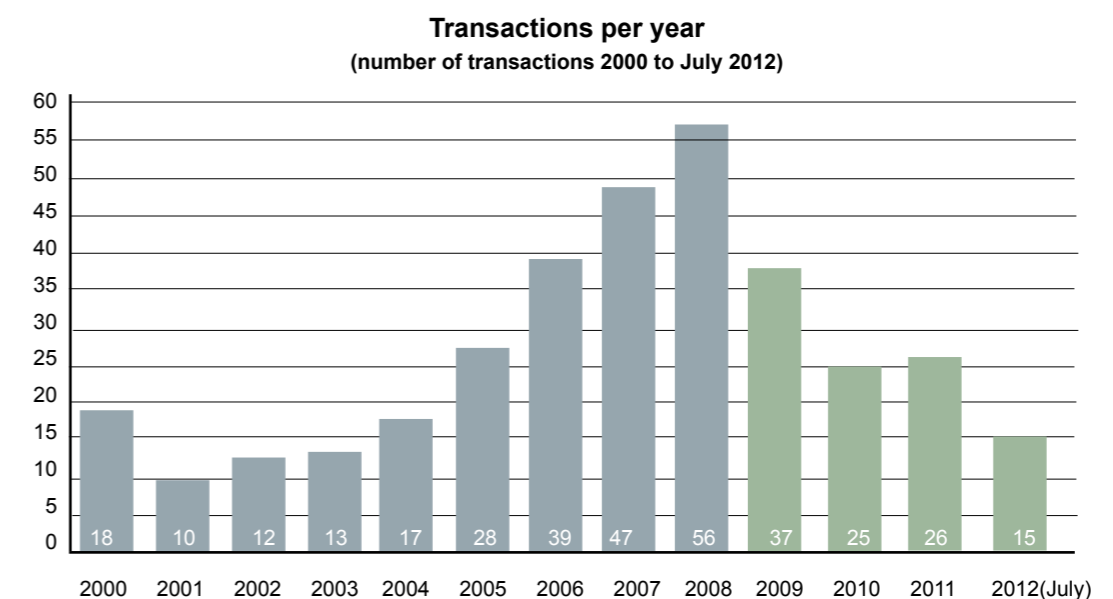
There are numerous investors that are known to invest in the South African venture capital asset class, over and above those that did participate in the survey, including Angel investors, Corporate investors, Enterprise development initiatives, and well-known entities such as Business Partners. However, the following

survey references only data obtained from investors that did participate in the survey and that supplied useable and relevant data. The actual scope of the venture capital asset class in South Africa is therefore broader than that indicated in this report, with the exact magnitude only speculative.

5. Venture Capital transactions: comparison

Summary of Investments		
	2000-2010	2009-2012
Number of venture capital fund managers invested in period	33	22
Number of investments made during the period (Venture capital fund managers only)	197	103
Average transaction (value)	R10.5m	R8.11m
Total amount invested in survey period	R 2,638bn	R 0,835bn
Total amount invested in venture capital asset class at end of survey period	R 2,324bn	R 3,084bn

6. Number of transactions conclude



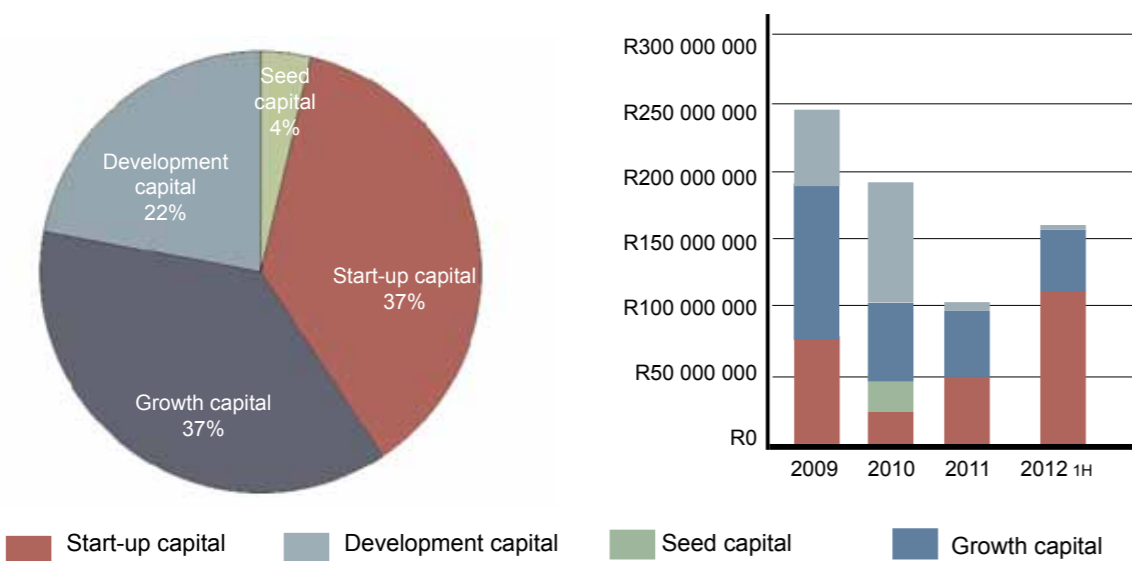
The above graph, indicating the number of transactions concluded in the venture capital asset class for each of the last 12 years covered by both the 2010 and 2012 surveys, follows a similar pattern as recorded for private equity as a whole in the recent SAVCA/KPMG South African Private

Equity report. The number of transactions spiked in 2008, then dropped off in 2009 due in part to the onset of the global recession, but more because investors who raised money between 2005 and 2008 had invested the majority of their funds between 2006 and 2008.



7. Contribution by stage of the deal

Contribution by stage of deal (by value)



The largest proportion of transactions concluded in the period was in the early stage of investments, including seed and start-up capital. 2009 and 2010 reflecting a substantial number of deals involving follow-on investments. This shows a

healthy appetite amongst investors in early stage and start-up transactions, despite a substantial decrease in the number of transactions by the public sector (normally executing early stage seed and start-up transactions) compared to the 2010 survey.

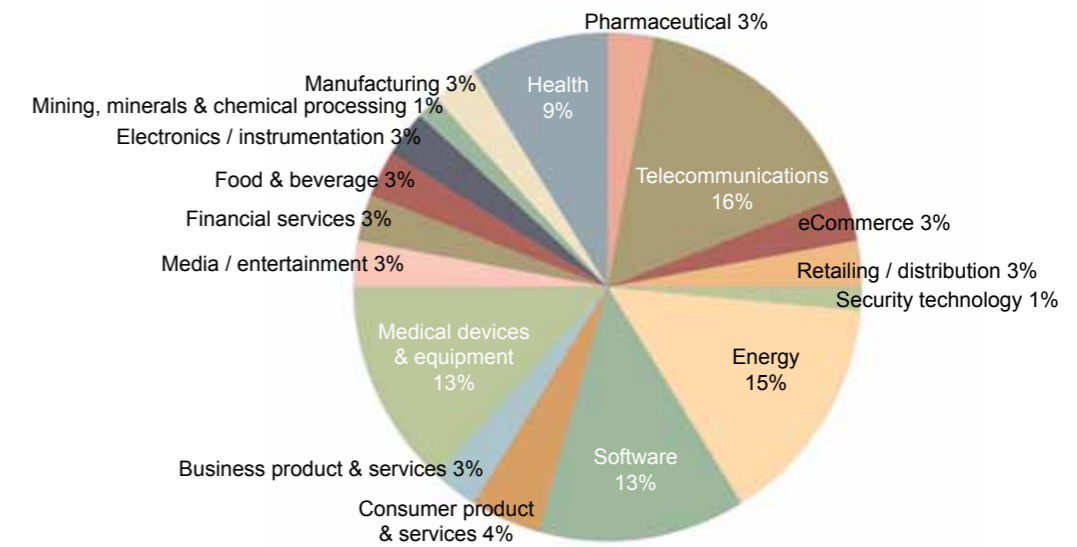
8. Sector allocation

Transactions were concluded in each of the main sectors of the economy with the largest recipient being Information and Communication Technologies (35%), followed by Life Sciences (health, pharma and medical devices; 25%). Energy, a sector not normally associated with venture capital given substantial capital requirements (case in point is Optimal Energy and the discontinuation of the Joule electric car for lack of industrialisation funding) received upwards of 14% investment, making it the second largest

single sector recipient of venture capital funding. Energy was not a major feature of venture capital investment in South Africa prior to 2009.

Substantial existing biotech investments are still on the books of primarily public funded investors, following the work of the former Biotech Regional Innovation Centres (BRICS – now incorporated into the Technology Innovation Agency (TIA). However, biotech received virtually no new funding in the latest survey period.

Sector allocation by number of transactions

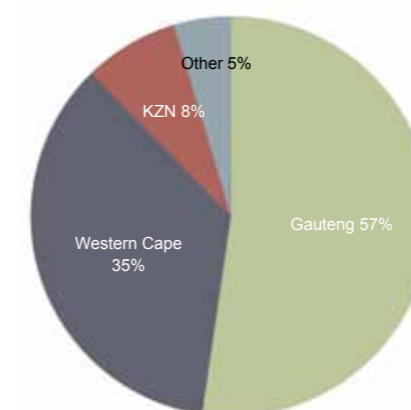


9. Location of transactions

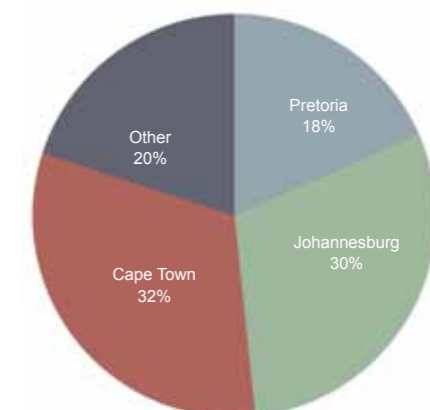
Gauteng province still accounts for the majority of venture capital investments but Cape Town is the city with the largest number of transactions in the survey

period. Transactions in other parts of South Africa received more focus than in the previous survey.

Location of transaction by province

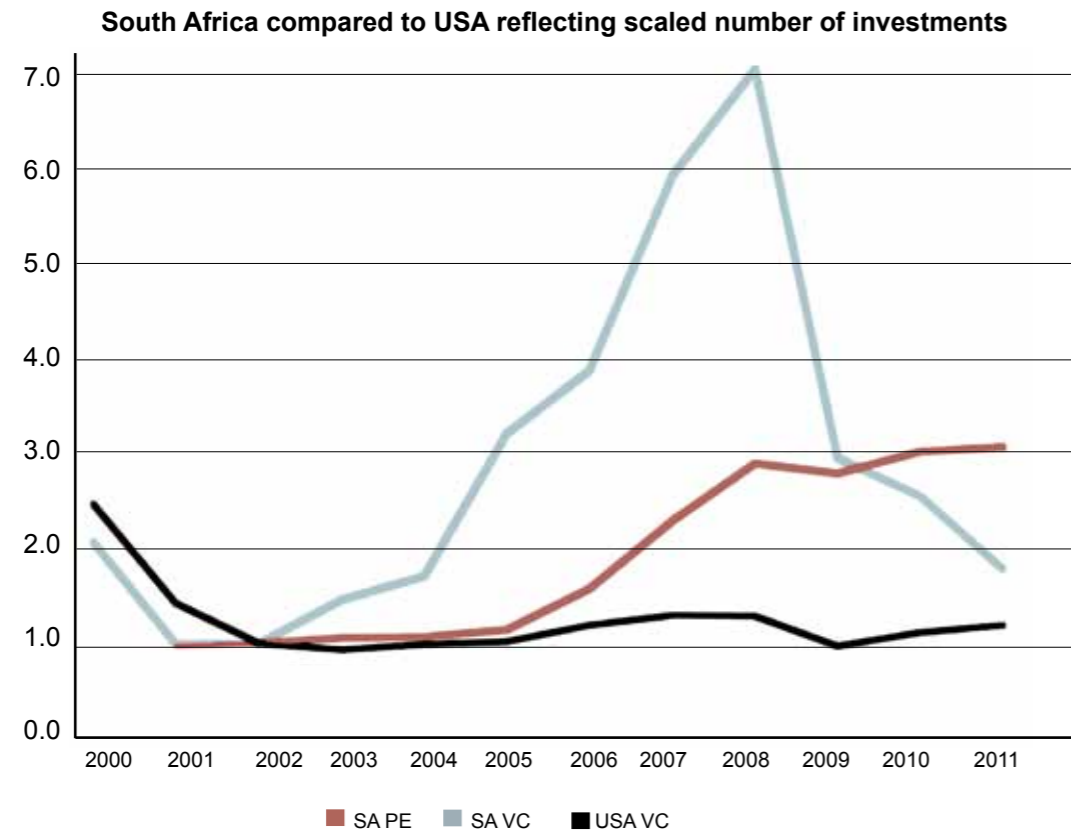


Location of transaction by city





10. Global comparison

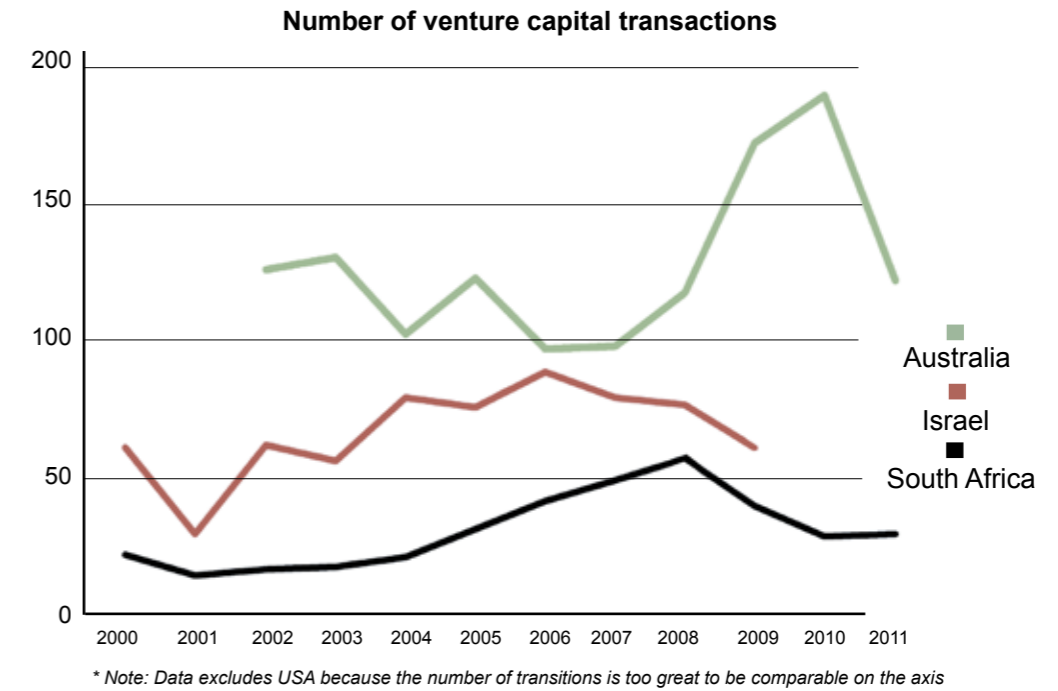


The above graph charts the investment trends of the SA venture capital asset class since 2000, compared to the investment trends of the local private equity sector, the SA GDP and investment trends in the US venture capital asset class. 2001 was used as the base year for comparison.

The data indicates a disproportional growth in the SA venture capital asset class between 2005 and 2009 when compared to the relative decline of investment in the US venture capital

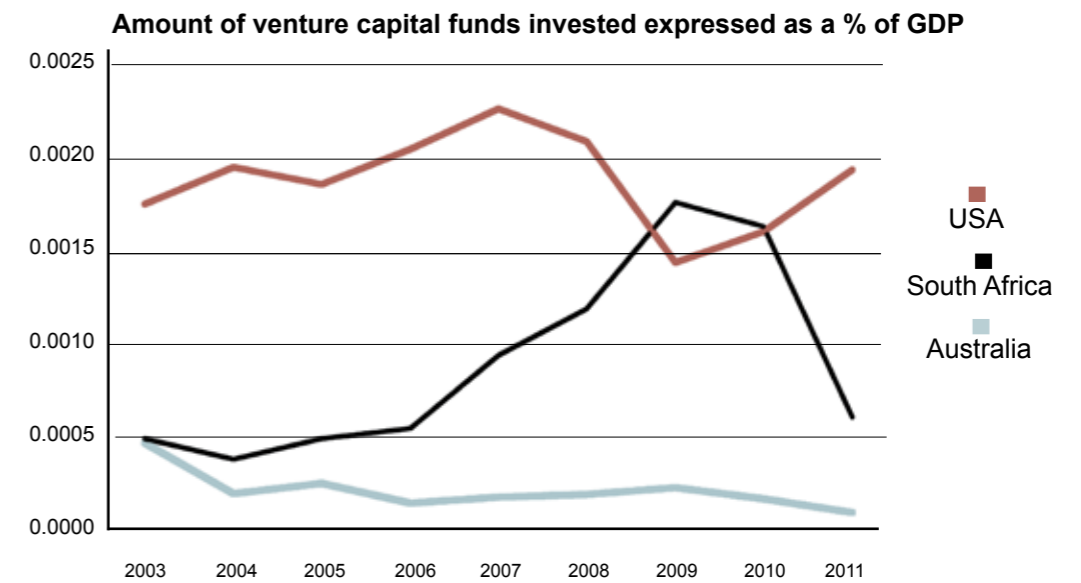
asset class. Although this is a positive trend, it needs to be borne in mind that the growth builds off a low base.

Investment in the SA venture capital asset class followed a similar trend as that of SA GDP with the spike in venture capital investment activity in 2008 reflecting the spike in SA GDP in 2007 – venture capital fund managers were investing funds in 2008 based on their ability to raise funds on the strength of the economy up to 2007.



The SA venture capital asset class produced a noteworthy increase in the number of transactions following the dot-com era. However, the number of transactions is significantly lower than Israel and Australia, and substantially lower more recently than India.

The following graph shows the number of annual venture capital transactions normalised against each country's GDP.



Who invests in the South African venture capital asset class?

The South African venture capital asset class is comprised of a diverse set of investors, grouped in the following standard way to include:

Angel investors

Angel investors are defined as private investors, often with entrepreneurial experience that invest some of their own money and experience in small entrepreneurial ventures.

Independents

An independent firm raising and managing venture capital funds from a number of funds and capital sources.

Captive (government)

An investment firm/operation tied to a single fund/capital source, raising (or drawing) its funding from National Treasury or the public sector.

Captive (family office)

An investment firm tied to a single fund/capital source, raising (or drawing) its funding from a private family.

Captive (corporate venturing)

The process by which a large company (private or public) invests in new business opportunities (start-ups or small businesses) for strategic reasons.

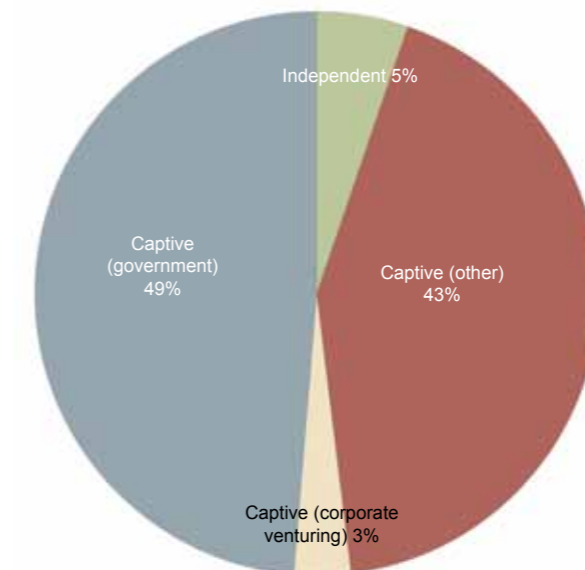
Captive (single sponsored fund)

An investment firm/operation tied to a single fund/capital source.

The 2009-2012 survey did not include a separate component probing Angel investments as was done for the 2000 to 2010 survey, as it is becoming increasingly difficult to get representative data from Angel investors related to concerns of confidentiality and the preference for such investors to remain under the radar in so far as public surveys are concerned. Furthermore, other investors not formally linked to SAVCA, such as corporate investors (mergers and acquisitions (M&A), enterprise development, etc.), SME loans, grant mechanisms and so forth are also active in this space, but such transactions are not included in the survey as information on such activities are not publicly disclosed, and most such incumbents don't consider themselves venture capital fund managers, and thus are not members of SAVCA.

11. Total number of investments per type of fund

Number of transactions by type of fund manager (by value)



Government backed investors were the most active during the period under review, despite TIA making considerably fewer equity investments following its incorporation, than when operating as seven separate entities. This was due to limitations on TIA's ability to conduct equity-type investments post amalgamation. The agency did however conclude a substantial number of loan-type transactions (approximately R100 million) during the period. Many of the transactions recorded by Captive (government) funders during the period were for follow-on investments into existing deals.

Corporate investment, fuelled by M&A appetites and enterprise development, is under represented in the data, as most such transactions are not reported officially. Certain corporate investors who participated in the survey interviews opted not to supply transaction data as a result of internal public disclosure policies. The above graph is thus a distortion of the actual number and type of investment managers active in South Africa, but is an accurate representation of SAVCA members.



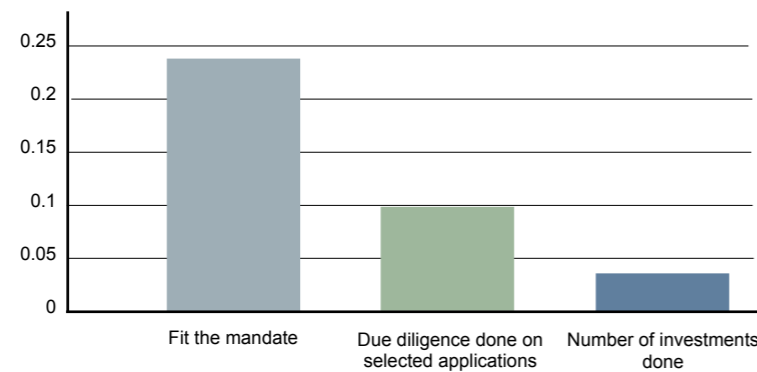
12. Deal flow reported

The amount of annual deal flow seen by investors is the same as in previous periods, with the vast majority of deals received not fitting

the stated mandate of the investor.

Average deal flow amounted to an average of 274 per year per fund manager.

Deal flow fitting the mandate (% of total proposals received)

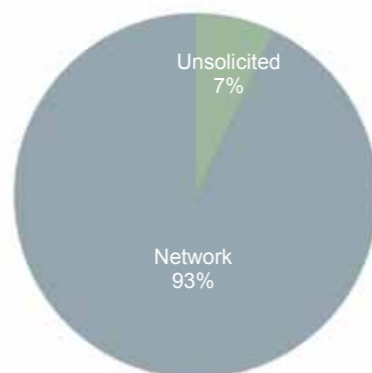


13. Origin of deal flow

Data also revealed that most deals leading to investment were sourced

from within the networks of fund managers.

Average annual deal flow reported



Only public sector funders (i.e. Captive government) recorded transactions involving public funded institutions (PFI) (e.g. universities and science councils). However, some private

investors disclosed in interviews that they are currently looking into PFI type transactions, but none reported deals concluded with PFI's at the time of the survey.

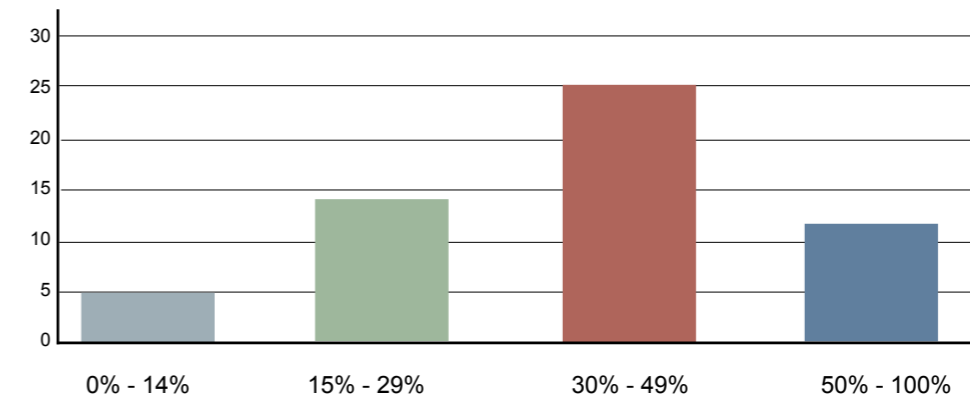
14. Equity preferences

Those investors holding upwards of 50% equity stakes in investees did so as a result of follow-on investments in existing transactions, thus increasing their equity stakes with each subsequent round of investment. The majority of

equity stakes in transactions fell into the range of 30% to 49%, typical of early stage transactions.

Average equity taken per investment was 39,71%.

Equity negotiated by fund managers





15. Exit history and options used

Few exits were recorded during the survey period, with the majority of deals still active at the end of the survey period.

In the period in question 12 full exits as well as 4 partial exits were recorded.

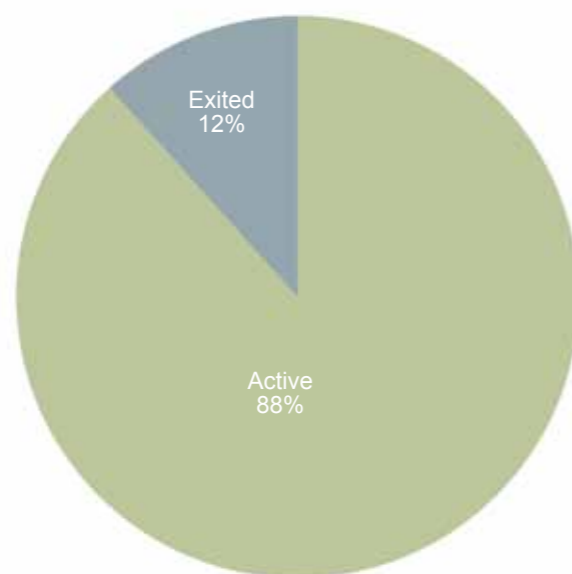
Fund managers are still reluctant to report exit information. However, notable public exits include VISA's acquisition of Fundamo, a US\$ 110 million transaction, which greatly skews the overall figure regarding exits in the period. Each of the major VC fund managers surveyed reported having concluded exits during the survey period. The overall figure for exits concluded

during the survey period is estimated to be upwards of R 1 billion.

It is important to note also the activities of corporations through M&A activity – mostly not reported publicly. Exit activity during the period included a substantial transaction involving the South African social media sensation MxIT.

The survey responses indicated a healthy track record of exit activity by almost all key investors surveyed. However, more effort is required to track and report such fund performance data, in so far as establishing a credible track record for the ultimate indicator of the SA VC asset class."

Number of investments still invested in the deal

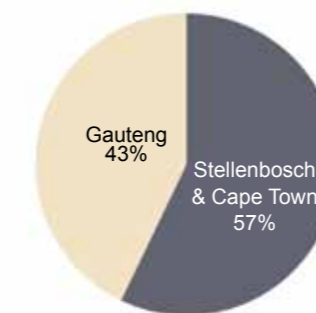


16. Location of venture capital fund managers

The preference for location of venture capital fund manager office has changed from the previous survey, with the majority of investors now reporting to prefer the Western Cape (Stellenbosch and

Cape Town) as the base for operations, despite the majority of investments (only marginally) still flowing to Gauteng based transactions.

Location of fund managers

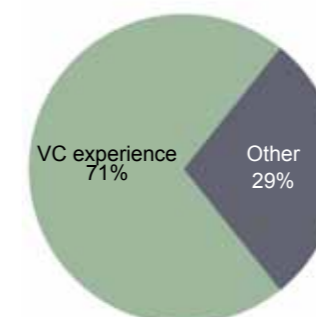


17. Experience

The venture capital industry as a whole is benefiting from increased transaction experience, with almost 70% of fund managers reporting that their team has past investment experience; less than a third conducting venture capital-type activities

for the first time. A substantial number of team members have past investment experience with investment banks, private equity investors and other non-venture capital-type financial service providers.

Fund manager experience



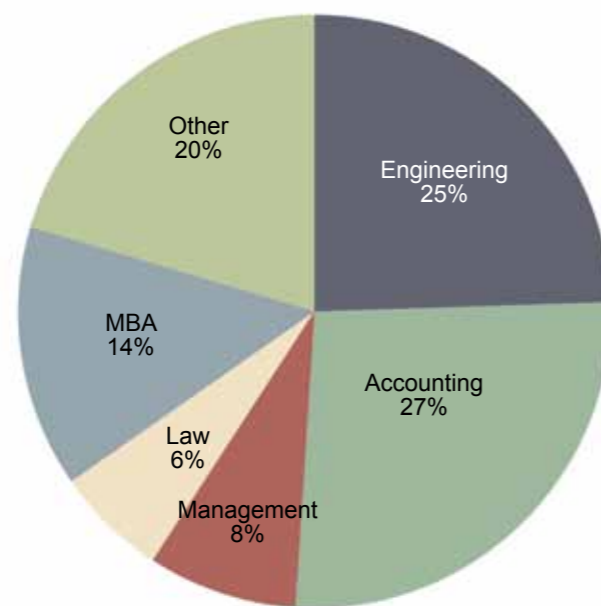


18. Training background

Fund managers with financial backgrounds still dominate the investment teams. However, this is becoming less of a trend in comparison

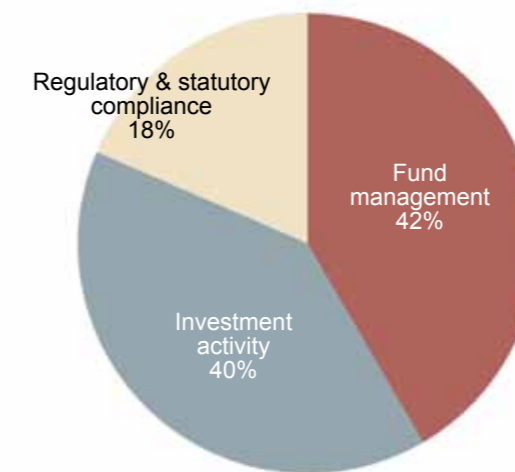
to the previous survey, with management teams now having more candidates from science and engineering backgrounds.

Basic experience of VC manager



19. Management time allocation of venture capital fund managers

Management time allocation of VC fund manager



There appears to be a healthy split between the amount of management time allocated to primary fund management and investment activities, despite concerns

of increasing regulatory and statutory compliance requirements facing investors in South Africa.

20. Undrawn commitments and new fund management activities

The majority of venture capital fund managers in South Africa operate using a drawdown facility from their primary backers. This makes it difficult to ascertain a reliable estimate of the amount of money available for new investments, being capital already committed but not deployed. Responses to this from interviews with active fund managers validated this point as many of those with active investment portfolios have open credit lines with from to motivate additional capital if required.

Notable during the 2009 to 2012 period is that a number of fund managers were able to obtain additional capital commitments from existing funders, and that there are new fund managers launching facilities in the venture capital asset class. One fund manager that participated in the 2010 survey has ceased operations as a result of its inability to raise a second fund. An interesting development is the emergence of enterprise development backed funds, as well as investment activities stemming from business incubation and support entities, primarily driven by the private sector.



Standing back

The following section briefly outlines inputs from survey respondents in relation to the development and future of the venture capital asset class in South Africa, based on standard questions framed in the questionnaire used for the survey.

“Indicate from your experience the key inhibitors to the success of venture capital funds”:

- The following were the three inhibitors most selected by respondents, ranked in priority.

Contributor/focus area	General responses
Lack of skilled entrepreneurs	All respondents, bar one public funder, confirmed that they were able to find suitable deals to invest in. The fact however that lack of skilled entrepreneurs was selected as the primary inhibitor is an indication that fund managers are finding it harder to find suitable deals compared to previous years as this inhibitor did not feature prominently in responses to the same question posed in the 2010 survey. This may be attributable to an increase in the number of fund managers possibly pursuing the same transactions, as the number of deals reported in the deal flow section of the survey, did not increase from 2010 figures.
Suitable management for venture capital invested businesses	South Africa does not yet have a pool of start-up managers who have experienced venture capital-backed start-ups and exits. This means that high-growth businesses have to rely either on the founders to develop into experienced management, or to compete with the corporate sector to attract management talent. This is evident in the higher-than-expected remuneration often demanded by start-up founders, illustrating a misconception that start-ups offer remuneration on par with industry, as opposed to relying on future equity growth as a primary avenue for remuneration.
Lack of exit mechanisms	As more fund portfolios are maturing, more and more fund managers are facing the challenges of exiting on a larger scale. Trade sales were still reported as the primary avenue for exiting.

“Score the highest probability in terms of future plans and activities”:

- The following were the three options most selected, ranked in priority.

Contributor/focus area	General responses
Over the next 12 months, the venture capital industry’s outlook for finding suitable investment deals	This response validates the above comments against ‘Lack of skilled entrepreneurs’ selected as primary inhibitor, as the majority of respondents to the 2012 survey indicated that venture capital fund managers are confident finding suitable transactions in the next 12 months. Discussions regarding this topic during interviews pointed to the fact that venture capital fund managers are having to play a hands-on role in investments, due to lack of suitably skilled and experienced entrepreneurial management teams, and that this is in fact a defining attribute of the venture capital asset class in so far as VCs contributing much more than capital, but also expertise, management time, networks and more.
Over the next 12 months, the venture capital industry’s outlook for raising additional funds for investment	Fund raising, especially from institutional sources (insurance, pension funds, banks, etc.), is still reported as an extremely difficult process as highlighted in the previous survey. Some fund managers have reportedly received unsolicited interests from European venture capital family offices, seeking investment opportunities in emerging markets. However, most fund managers were confident that they would raise sufficient additional funds with which to conclude new transactions, based on current relationships, portfolio performance, and successful exit track records.
Over the next 12 months, the venture capital industry’s outlook for securing follow-on funding for ventures	This was explained mostly due to the fact that the majority of fund managers operate within the context of drawdown or annual budget facilities, thus able to motivate follow-on funding for existing transactions from existing funding sources based on trade history and deal performance.



Conclusion

Venture capital in South Africa is still an emergent asset class. The data from the 2012 SAVCA Venture Solutions VC survey shows that the asset class is picking up steam, both in number of annual transactions, and in the number of fund managers. Similarly, South Africa's high-growth entrepreneurial system is producing notable exits, such as VISA's acquisition of Fundamo, as well as a spate of recent start-up acquisitions, many of which are based in Cape Town.

The asset class is nevertheless substantially smaller in size compared to the amount under investment by South African private equity players (> R 100 billion) or in comparison to the market capitalisation of the JSE. This raises important questions as to the role and impact of venture capital in stimulating the growth and development of the South African economy, which was the focus of a workshop facilitated by Harvard Business School Professor Josh Lerner at the Industrial Development Corporation in May 2012 to investigate ways in which to use public funds to stimulate local venture capital.

The above statistics and findings will shed some light on the magnitude of venture capital in South Africa, and the nature of South African venture capital fund managers. But more research and out-of-the-box thinking, and doing is needed to develop the venture capital asset class, especially as it is sometimes perceived as the starting point for efforts to promote job creation and new venture formation, when in fact it forms one of many interconnected interventions alongside the availability of entrepreneurial talent, novel and globally competitive intellectual property, and liquid markets, to name a few.

In this regard, it is believed that this survey will stimulate more in-depth analysis leading to a new strategy for the development of the VC asset class as a whole. In doing so, it is hoped that the 2012 survey will motivate the case for existing funders, including government, to pour more capital into early stage transactions, and attract new players to the asset class based on a proven track record and the performance of the asset class.

Stephan J Lamprecht
Venture Solutions

About Venture Solutions	About SAVCA
<p>Venture Solutions is an innovation management and commercialisation consultancy active in sub-Saharan Africa. The focus is developing high-tech start-ups. Know-how and methodologies target commercialisation of new technologies, leveraging intellectual assets for business profits, and structuring start-up businesses for sustainable growth.</p>	<p>SAVCA intends playing a meaningful role in the venture capital and private equity industries.</p>
<p>The business operates in three key domains as well as the vital overlap and interplay between those domains, being:</p>	<p>The main objectives of SAVCA are to:</p>
<ul style="list-style-type: none"> ■ Advising corporations, established SMEs and public sector enterprises; ■ Advising universities, research labs and science councils in the management of technology transfer; and ■ Consulting to the start-up ecosystem including business incubators, science parks, venture capital & angel investors. 	<ul style="list-style-type: none"> ■ Promote the venture capital and private equity profession in southern Africa ■ Represent the profession at the national and international level. ■ Develop and stimulate professional and transactional venture capital and private equity investments throughout southern Africa. ■ Stimulate the expansion of venture capital and private equity throughout southern Africa. ■ Collect information from markets and from members. ■ Circulate information to members and the outside world. ■ Stimulate and maintain contacts within the membership. ■ Contribute to the management development of investors and investees. ■ Provide the relevant authorities with proposals for improvement in the corporate, fiscal and legal environment for venture capital and private equity in southern Africa. ■ Maintain ethical and professional standards.

