

# Private equity preferred in current economy

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Using private equity to gain capital, particularly for small to medium-sized enterprises (SMEs) that might not meet the criteria to qualify for bank loans, seems like a preferential means of raising capital in South Africa's current tough economic climate, according to private equity company RMB Corvest.

Although a company can raise loan finance from banks, it would need to offer security and be subject to strict covenants while paying back the loan, says RMB Corvest director **Mike Donaldson**. However, not all companies – more specifically private companies – have security to offer the banks, he continues.

“Additionally, should a company not have a record with a financial institution, the quantum of debt actually raised may not be sufficient to meet its requirement,” he says, adding that a major drawback of debt funding is that these loans need to be repaid over a specified period, which could be a challenge for expanding companies.

He explains that private equity, generally, provides funding in exchange for a shareholding or equity in a company. “Provided cash flows are positive and the management team has a record of delivering profits, the company would be attractive to a private equity player,” says Donaldson.

A major benefit is that equity is not a loan; hence, the cash flow of the business will be improved, instead of the debt structure, he points out. New equity funding for the business will also strengthen the balance sheet and allow for future growth.

## Obtaining Private Equity

RMB Corvest director **Stephen Brown** says private equity is readily available to existing companies with a record of good sustainable profits. “There are numerous private equity players in the market which specialise in different industries. Most of them will have a preference in terms of the size of company in which they would ideally like to invest.”

Further, private companies might find it increasingly difficult to raise debt from banks, considering South Africa's current, unstable economic status, he says.

“However, private equity can take a medium-term view and advance capital, provided the business case looks sound,” suggests Brown.

RMB Corvest can advance a mixture of pure equity, interest-free loans, interest-bearing loans and preference share capital.

“Funding by RMB Corvest is tailored to each business to prevent the company from being overburdened by lending covenants



## FUNDING OPTION

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and demanding repayment profiles,” he says.

The key criteria considered by private equity providers includes the company having an established management team, a history of profits and the business operating in a market that supports stable and positive cash flows.

Further, a good audit history with reliable yearly financial statements will be required, as well as management-prepared annual budgets and forecasts, with continual measurement of the company's accuracy in predicting profits and cash flows.

Moreover, sustaining profits will largely depend on several factors, says Brown, adding that the main drivers in the South African landscape would include the rand:dollar exchange rate, interest rates and potential strike action affecting specific segments of the market. ■

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