

STRATEGY

The changemakers

More than 30 years after it was founded, Ethos Private Equity is still a pioneering force in the industry in South Africa. CEO **Stuart MacKenzie** discusses the firm's latest endeavours

André Roux broke new ground for private equity in South Africa when he founded Ethos Private Equity in 1984. Working initially with local investors, in 1996 he raised the firm's third fund, its first to include international LPs. That moment was an inflection point for the firm and in the maturity of the South African industry. Today the firm has reached another defining moment as it broadens its product offering from a single-fund model to three strategies and launches a listed permanent capital vehicle to support its upcoming fundraisings, Ethos chief executive officer Stuart MacKenzie tells *Private Equity International*.

Q There's been a lot of developments at Ethos this year – what has been behind this?

The genesis was looking at our business and asking “where's the next five to 10 years of growth going to come from for Ethos?” Growth in our firm had come from raising larger and larger successor funds, and we realised that growing our funds from where we are today is going to be more challenging. We were also mindful that with the size of funds we have today we're able to buy companies that are squarely in our sweet spot.

So it was really a growth agenda that drove us to look at a diversification strategy. Within that we didn't want to go too far away from what we're comfortable with. We've always had in the back of our minds to go back to the size of deals we were doing in Funds III and IV. We see a number of deals a year through our origination processes that we don't do because they're too small, not because we don't like them.

Mezzanine also is a space we'd looked at many times over the years. What catalysed this was there was a highly successful team out there looking to raise a new mezzanine fund. It's a team we're very familiar with, we've worked with them on both sides of the table, and being able to plug them into Ethos's institutional platform accelerates a mezzanine strategy for us and for them.

Q Is there high demand for mezzanine in South Africa?

As a product set, we see a greater and greater opportunity for mezzanine for a whole host of reasons. In South Africa, the tightening of banking regulations means there's an increasing need for mezzanine in funding transactions. In sub-Saharan Africa a number of the deals that we see are actually better suited to a mezzanine product that has a self-liquidating programme with an equity-like return as opposed to trying to realise a minority stake in a high-growth business where you're partnering with entrepreneurs who don't want to exit at that point in time.

Q How does Ethos Capital play into the new strategies?

We realised that fundraising cycles could potentially be a constraint on diversifying our product strategies. We felt having a permanent source of capital to seed these various strategies would become increasingly important. And so we started to evolve the thinking around a JSE-listed vehicle and investigate whether there would be appetite for something like that.

The more we looked at it, the more convinced we became that it was actually an



MacKenzie: Ethos's diversification strategy is driven by a long-term growth agenda

ideal solution to somewhat de-risking the fundraising cycle uncertainty.

We had to find innovative solutions to a number of issues principally around protecting investor interests while setting the vehicle up to trade at a premium valuation. Key to achieving these objectives has been to ensure that Ethos Capital is independently managed, with its own independent investment committee headed by senior executives (with track records in the financial services industry and private equity specifically), making sure that the fee structure aligns interests between the manager and investors, and making sure there was a clear strategy to manage cash in the vehicle so as not to have a cash drag. As we solved these problems, Ethos Capital came into life.

Q A listed vehicle comes with a higher burden of transparency and reporting. Was that a concern?

We have spent a lot of time thinking about reporting and how we're going to achieve a balance between transparency and ensuring we don't over promise our ability to ultimately realise the returns our investors are looking for. That balance, we think is capable of being met.

It does obviously put us more in the public domain than we're used to, and is going to require some new skills, but I think that's got to be, in the long run, good for the asset class and good for us.

There's still quite a lot of misconceptions about private equity as a model and how we do what we do and generate the returns we generate. Demystifying that is ultimately going to be good for the industry in South Africa and good for investors. We realise

it's going to take time and ultimately it's going to take delivery, and we're prepared and excited to walk that road.

Q The mezzanine platform was created by bringing in an external team. Do you anticipate doing the same with other teams?

That model could have a broader application going forward whereby teams who are looking to raise a second or even a third fund that are struggling with building the institutional platform that's required these days might find it easier to do that under a broader umbrella, with an institution that's already built a platform. We want to prove out the model with the mezzanine and mid-market teams and then I think we'll certainly be on the lookout for other opportunities in that vein.

We're very cognisant of what we're good at and what we know, and the further away we drift from that, the more important it will be for us to bring in expertise to manage those asset classes. But certainly we would be open to looking at infrastructure or real estate.

Q How is Ethos working to remain at the forefront of the private equity industry in South Africa?

We do challenge ourselves to innovate and constantly evolve to meet the needs of our investors and portfolio companies. This drive for agility and innovation was set by our founder and is core to Ethos's culture. Volatile, unpredictable, uncertain markets require you to always be looking at your next horizon of growth and ensuring that you build capacity to execute. ■

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Stuart MacKenzie joined Ethos Private Equity in 1998 and became chief executive officer in 2014. In addition, his roles at Ethos have included being responsible for the investment programme of the Technology Fund and leading the firm's investment process and talent management functions. Prior to joining Ethos, he spent two years at JP Morgan Chase Bank NA.