

### **Private equity is a good thing...**

The recent surge in bids by private equity funds for listed companies is we believe, contrary to many public comments on the matter, a net positive trend for local retirement funds and unit trusts.

When we consider selling our clients' holding in a listed company we evaluate the attractiveness of the alternative uses of the potential proceeds of the sale. This entails comparing the value implied by the offer relative to:

1. Other opportunities available in the equity market
2. Our expected returns from other asset classes (including cash)

The good thing about private equity is that it increases the number of potential buyers for our client's assets. As an analogy, it is far easier to sell one's house at a good price if there are ten interested buyers rather than two or three. An increased pool of buyers is a clearly a good thing for owners of undervalued assets.

Accepting a buy-out offer for a listed company is not a pursuit of short-term performance but selling an asset at what we believe to be its intrinsic value and reinvesting the proceeds in alternatives that are trading at bigger discounts to intrinsic value. This is a judgement of relative value that investors make on a daily basis when buying and selling shares on the stockmarket in the course of normal trade. The latter is just less dramatic and less newsworthy.

The current global excess liquidity looking for a home has resulted in historically narrow credit spreads. In other words, investors are currently accepting very low returns in compensation for assuming risk. A lot of this liquidity is funding private equity transactions. Private equity players are not blessed with some kind of foresight unavailable to other market participants – they will have winners and losers too. What they have access to is the above-mentioned low cost debt to leverage up (and down?) expected returns. Theoretically this allows private equity funds to pay higher multiples for each Rand of earnings than investors were prepared to for the company in its listed form.

Market participants will all have their own view on the prices being paid to take various companies private and there will always be a healthy natural tension between buyer and seller but the offer will have to be at a price attractive enough to gain the support of a majority of shareholders.

### **...but the proposed Shoprite deal is a bad thing**

It was recently announced, in a complicated transaction, that Brait (a manager of private equity funds) has made an offer to purchase and delist Shoprite. Shareholders can elect a cash consideration of 2550c or accept 2059c with a right attached to reinvest the remainder of the proceeds in a new leveraged unlisted vehicle housing the assets of Shoprite.

The Shoprite deal can be considered in terms of firstly, the attractiveness of the price being offered relative to our estimate of Shoprite's intrinsic value and secondly, the process whereby shareholders of Shoprite are able to exercise their right to vote on the merits of the transaction.

1. Relative attractiveness: We believe that the offer price undervalues Shoprite and that at current prices Shoprite is attractive relative to both the market and cash.
2. Process: The deal when looked at holistically is structured in such a way as to allow shareholders, some of whom hold high voting shares, and whom are in our view conflicted, to vote and thereby force the proposed transaction through effectively disenfranchising shareholders who hold a majority of the economic interest in Shoprite.

The potential buyers are aware that unit trusts and a majority of retirement funds will not, as a result of regulatory restrictions, be able to reinvest in the unlisted entity thereby diluting these funds' current economic interest in Shoprite's profits to the point of extinction in favour of Brait, Shoprite management and the (in our view) conflicted shareholders.

We will continue to publicly state our opposition to the structure of the transaction and have formally appealed to all the relevant regulators to recognise those shareholders (who are in our view conflicted) as conflicted and "related parties" and thereby preclude them from casting their votes at the relevant shareholders' meetings.

*Commentary by Duncan Artus, Portfolio Manager, Allan Gray Limited*