SPV-funded BEE deals are 'sure to fail'

■ Model depends on rising share prices – Lalu

Mzwandile Jacks

SPECIAL purpose vehicles (SPVs) – financial arrangements often used in black economic empowerment (BEE) deals – are unsustainable and do not work, but funders continue to use them because of the fees these structures generate, according to a BEE expert.

Ajay Lalu, a partner at Bravura Economic Empowerment Consulting, said on Friday that SPV models were a failure because they were premised on increasing share prices rather than cash flows.

"These assets are not carrying the same value any more because of the financial market turmoil," said Lalu.

"But it should have been known a long time ago that markets are fickle and driven largely by sentiment, as they are outside the control of BEE partners and management of the companies."

It was strange that partners in the first wave of BEE deals, as well as new participants, believed that something that was beyond their control could pay great dividends, Lalu said.

He emphasised that BEE moguls such as Tokyo Sexwale, Patrice Motsepe, Cyril Ramaphosa, Lazarus Zim and many workers included in these transactions would soon be "toyi-toying" on the streets because their investments would have been lost.

When the SPV structures were refinanced, as they would be, it would make them even more unsustainable, introducing systemic risk into financial markets, with the potential of big write-offs to the balance sheets of financial institutions, Lalu said.

Interest rates on BEE transactions averaged 15 percent, meaning there was a shortfall on the interest cover alone as the average dividend yield on the JSE was only 4.5 percent.

The shortfalls had to be funded by share price appreciation of 10.5 percent to cover interest, let alone any capital repayments, he said.

Analysts have told Business Report recently that deals involving the acquisition of shares, with no cash injection from the BEE partners but rather with financing from third parties, could collapse under the weight of high interest rates and volatile equity markets.

Analysts said the transactions likely to find themselves under water were SPV-type deals, which became popular about 10 years ago.

Many deals in South Africa were financed through SPVs, they said.

These included Shanduka Resources, a unit of Shanduka Group that struck an empowerment deal in 2005 with base metals producer Assore.

A 2005 empowerment deal between Anglo American and Kumba Resources resulted in the partial separation of Kumba's iron ore assets into a new company.

SilverBridge, the financial software solutions group, concluded a deal with Kagiso Trust Investments in 2006.

Hugo Steyn, the co-head of corporate finance at Investec, said that every equity-related BEE deal had an element of funding unless shares were allocated free to BEE parties.

"Even if the shares were provided at no cost to the BEE party, value would have decreased materially in the current market.

"Welcome to the world of equity ownership in volatile markets," Steyn said.

He said SPV was a term used for ring-fenced entities creating no liability for the BEE party.

"The value creation will depend on the initial price paid, the funding rate charged, upfront capital contributed by the BEE party, dividend flows over the period to the BEE company and debt provider, and the final exit price."

Ajay Lalu, a partner at Bravura Economic Empowerment Consulting, says funding for BEE deals should be premised on increasing cash flows, as black partners have more control over this than over fickle share prices

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