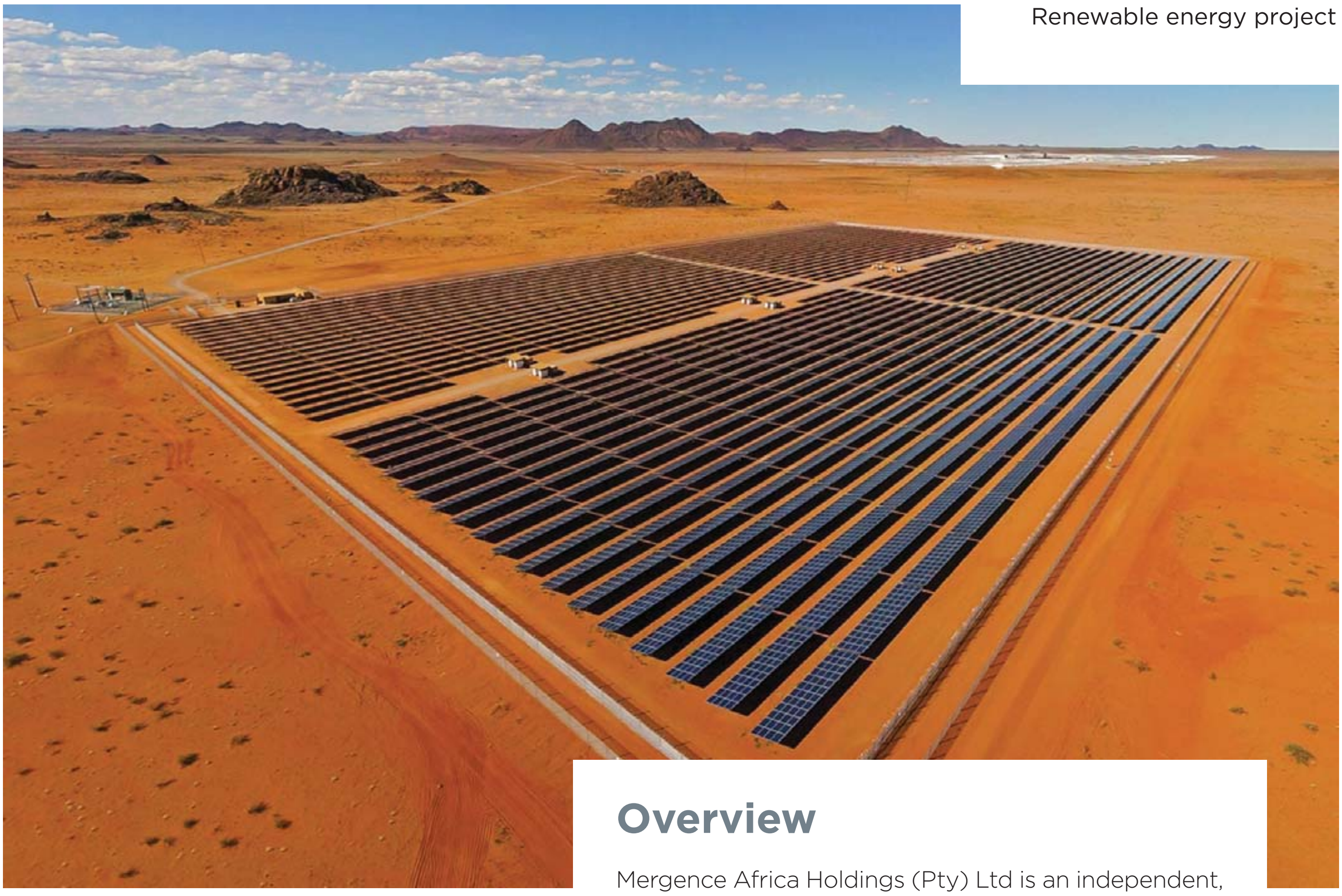
MERGENCE
INVESTMENT MANAGERS

Impact Report 2015

Our contribution to Infrastructure Development



Overview

Mergence Africa Holdings (Pty) Ltd is an independent, entrepreneurial, diversified financial services group founded in Cape Town in 2004 and is majority black owned.

Mergence has R26 billion of assets under management. The long-term objective and strategy is to build a truly South African financial services group providing world-class investment and financial solutions.

The group has three operating subsidiaries:

- Mergence Investment Managers (Pty) Limited – asset management
- Mergence Africa Capital (Pty) Limited – derivatives structuring and trading
- Mergence Africa Properties (Pty) Limited – real estate investment and asset management, including the successful JSE-listed Real Estate Investment Trust (REIT), the Dipula Income Fund

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FUND NAME	LAUNCHED	BENCHMARK	HIGH LEVEL DESCRIPTION
Mergence High Impact Debt Fund	16 Jun 2010	CPI + 3%	Aims to invest in debt investments issued to create positive and sustainable social and/or economic impact beyond the financial return.
Mergence ESG Equity Fund	16 Jun 2010	SWIX	Aims to outperform the JSE Shareholder Weighted Index (SWIX) while investing in companies with better than average Environmental, Social and Governance performance.
Mergence SRI Fund	16 Jun 2010	CPI + 3%	Blend of the Mergence ESG Equity Fund and the Mergence High Impact Debt Fund.
Mergence Renewable Energy Debt Fund (closed)	1 June 2012	JIBAR + 3%	Development impact fund which seeks to provide senior secured debt into the renewable energy sector enabling investors to achieve targeted investment returns together with social and environmental impact.
Mergence Infrastructure & Development Fund	1 Apr 2015	CPI + 7%	Invests primarily in social and economic infrastructure assets with a core focus on the renewable energy sector.

Making a difference

As part of our 10-year celebrations in 2014 Mergence produced a report describing our journey in impact and infrastructure investing. We showcased investee companies in the areas of **Housing, Education, Transport, Energy, Job Creation and Property in Rural Areas**. *(See summary of impact areas on page 6)*. All these investments are intact and performing well.

As a follow up to that report, we are proud to present a 2015 update as a way of sharing our activity in the areas of impact and infrastructure investing.

You will read, inter alia, about our strong **five-year track record** in impact investing, which shows that socially responsible investing (SRI) has come of age and should form an essential part of institutional investment portfolios. We were delighted to receive a **Gold 4-star rating from the Global Impact Investing Rating System (GIIRS)** (the gold standard for impact measurement in impact investing) for the Mergence High Impact Debt Fund, managed by Mark van Wyk, Mergence Head of Unlisted Investments.

During 2015 we launched a new fund, the **Mergence Infrastructure & Development Fund**, through which we have already invested in some exciting new projects, specifically in telecommunications and energy efficiency.

We have continued our expertise in **renewable energy** investing, with the team boosted in 2015 by the appointment of Kasief Isaacs, who developed and led PwC's South African renewable energy practice over many years.

In line with the Mergence ethos of **"shared value"** we have been actively calling on the pension fund industry to give serious consideration to impact and infrastructure investing. Portfolio managers Mark van Wyk and Kasief Isaacs have spoken at conferences and in the media on the benefits of this asset class. You can read their article at the end of this report.

I hope you enjoy the read and that you feel inspired to join forces in helping to build our beloved country for future generations. Please feel free to ask us for more information or request the individual fund factsheets.

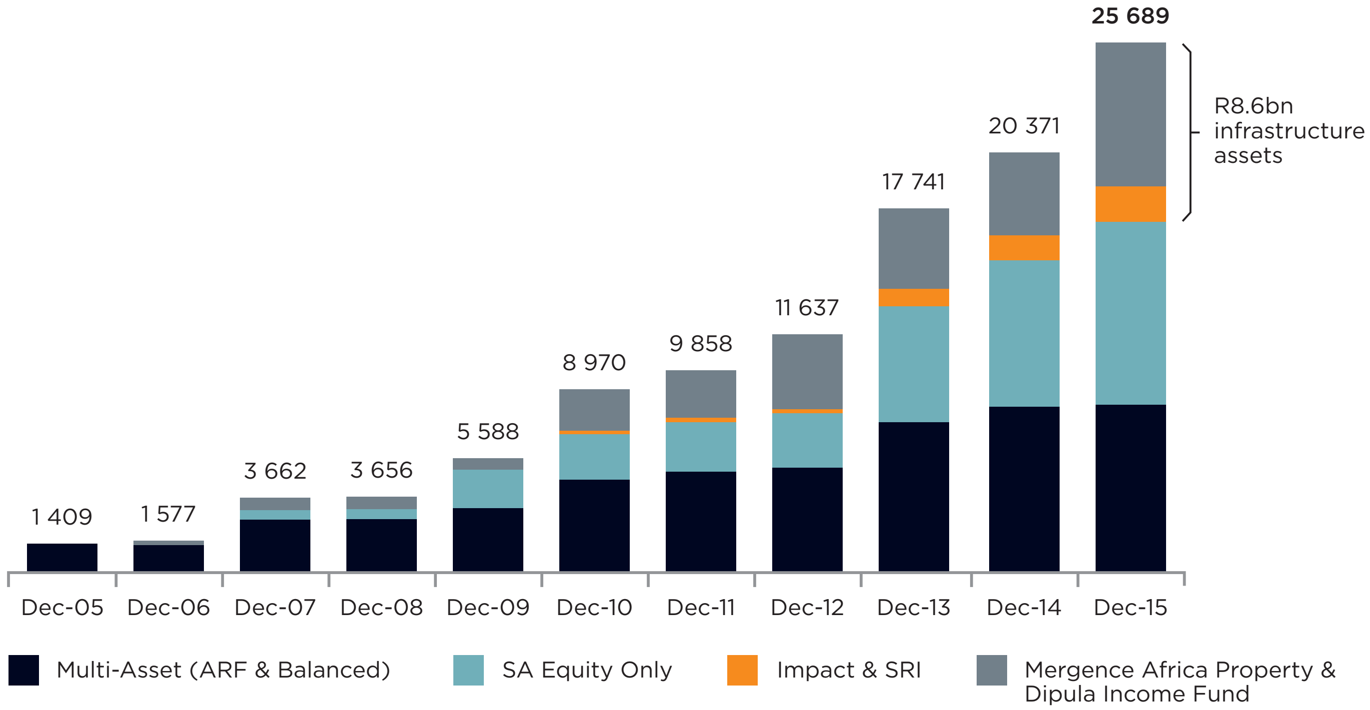
Yours sincerely

Fabian de Beer
Director: Investments

GROUP OVERVIEW

Social and development focused funds are a relatively small but growing part of our total assets under management.

The Mergence group has a total of R25.6 billion of assets under management, R8.6 billon of which represent assets aimed at addressing social and/or developmental issues within South Africa. See the graph below.



"The simultaneous crumbling of aging infrastructure in advanced economies and surge of development in developing economies will drive a steady four percent annual growth on infrastructure investment well into the second half of this decade, pushing total investment to a figure of four trillion dollars"; according to new research on the infrastructure investment market released by global business consultancy Bain & Company.

The pages that follow provide news and activity updates in each of our product areas. On occasion we have reproduced press releases and information published earlier in 2015; the intention is to give a snapshot at the end of 2015 of Mergence's growing investments in impact and infrastructure under the headings of the various investment product vehicles, presented in chronological order.

Bustling Gillwell Taxi Retail Park
in East London

Mergence impact areas

Existing projects, reported on in the 2014 report, plus all new investments during 2015*

Biomass renewable energy (RE)

Sustainable Heating

ICT

PROJECT ISIZWE
Free Wi-Fi For Africa

Solar & Wind RE

The updated portfolio is detailed on page 19

Education

eduloan™
unlocking potential

Job creation / Enterprise Development

ITIKENI Investment Company

Rand Trust
business, on your terms

Transport

SA Taxi
driving our nation forward

Social affordable Housing

Building homes and communities — over 80 years — COMMUNICARE

LENDCOR

TUHF

Infrastructure Property in rural areas

dipula INCOME FUND

*Investments made during 2015 are discussed on pages 7-12.

NEW INVESTMENTS

Infrastructure

Tshwane free WiFi project

Model could help with municipal infrastructure challenges

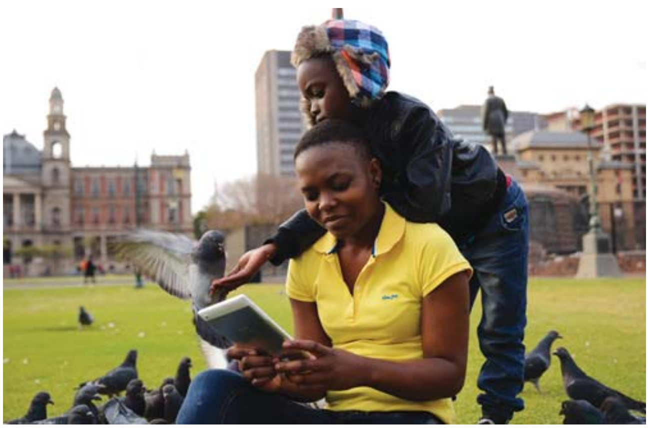
In 2015 Mergence provided financing to Project Isizwe to accelerate the roll-out of a free WiFi project sponsored by the Tshwane Municipality.

Project Isizwe is a hi-tech non-profit organisation headquartered in Stellenbosch.

The social impact of free WiFi in lower income areas has been well documented; indicating on average that every 10% increase in broadband penetration increases a country's GDP per capita by 1.28%, employment by 0.28% and facilitates the growth of small and medium sized enterprises.

The first phase of the Tshwane Municipality free WiFi project launched in November 2013 with five sites and a capacity of 25 000 users spread across five locations in Soshanguve, Mamelodi and Atteridgeville. Phase two with a further 213 sites was launched in mid-2014, while phase three, currently underway, will take the total number of sites to over 600, connecting over 700 000 users. Tshwane executive mayor Kgosientso Ramokgopa in his state of the capital address on 14 May 2015 said the intention was to provide every citizen of Tshwane (potentially 2 million people) with free WiFi within walking distance by the end of 2016.

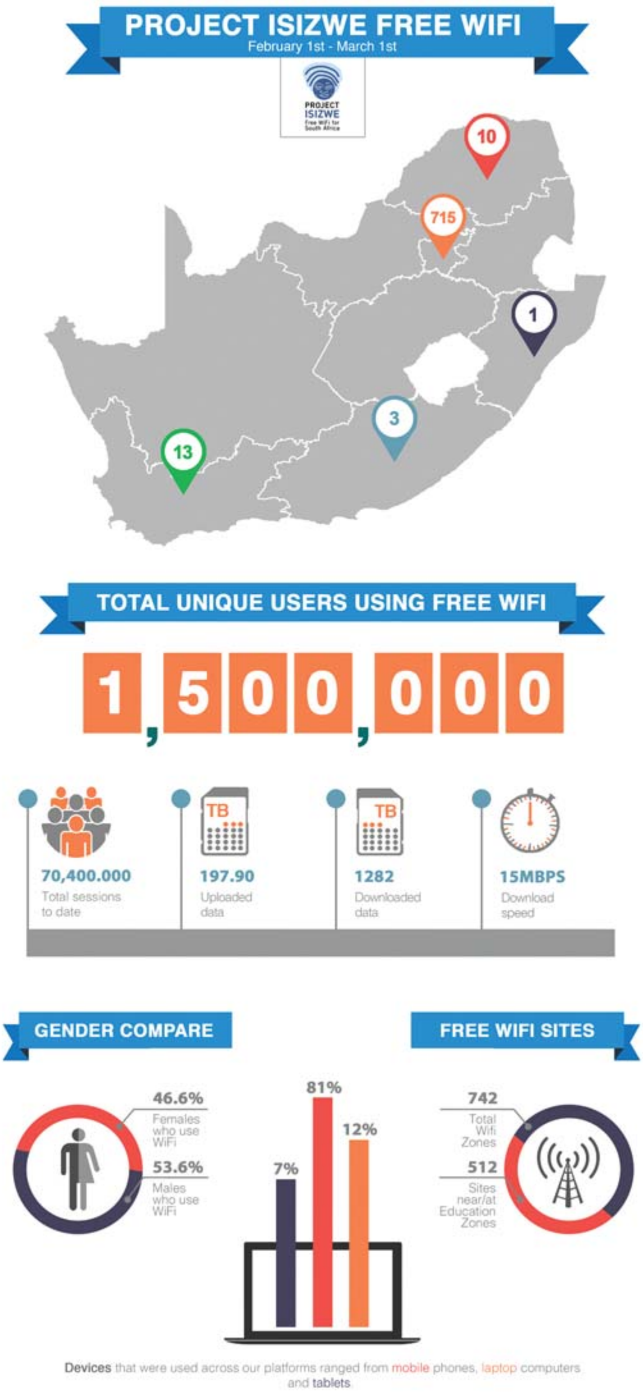
The Project Isizwe business model revolves around obtaining government sponsorship for the installation of free public WiFi zones located in low-income communities. The high cost of bandwidth is reduced using local service providers and partnerships with companies such as Neotel. Isizwe works with the owners and managers of fibre networks to give access to low income communities and geographically diverse areas which are viewed as uneconomical by many for-profit providers and telecommunication companies.

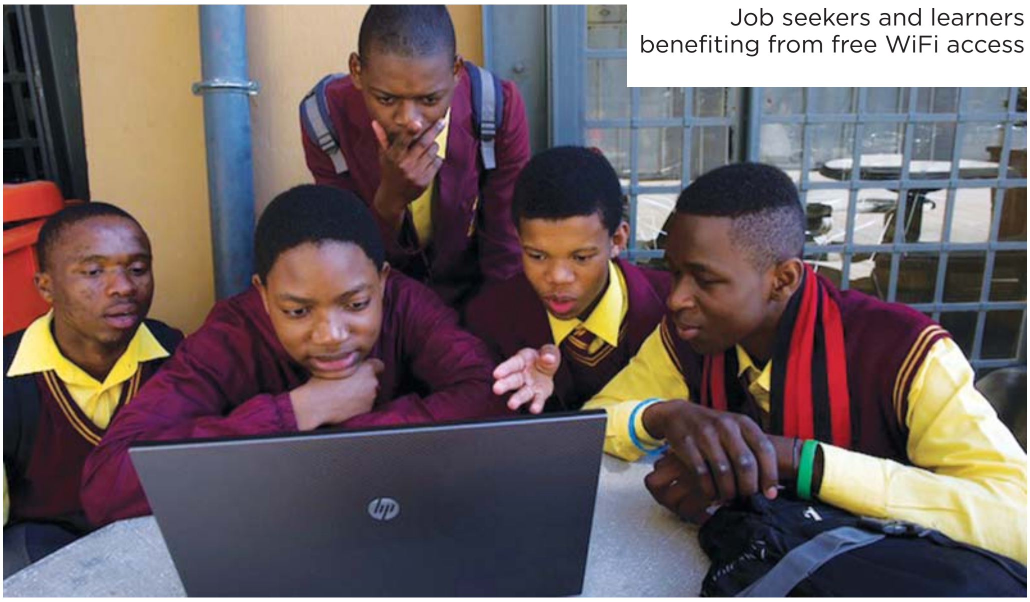


PROJECT ISIZWE
Free Wi-Fi For Africa

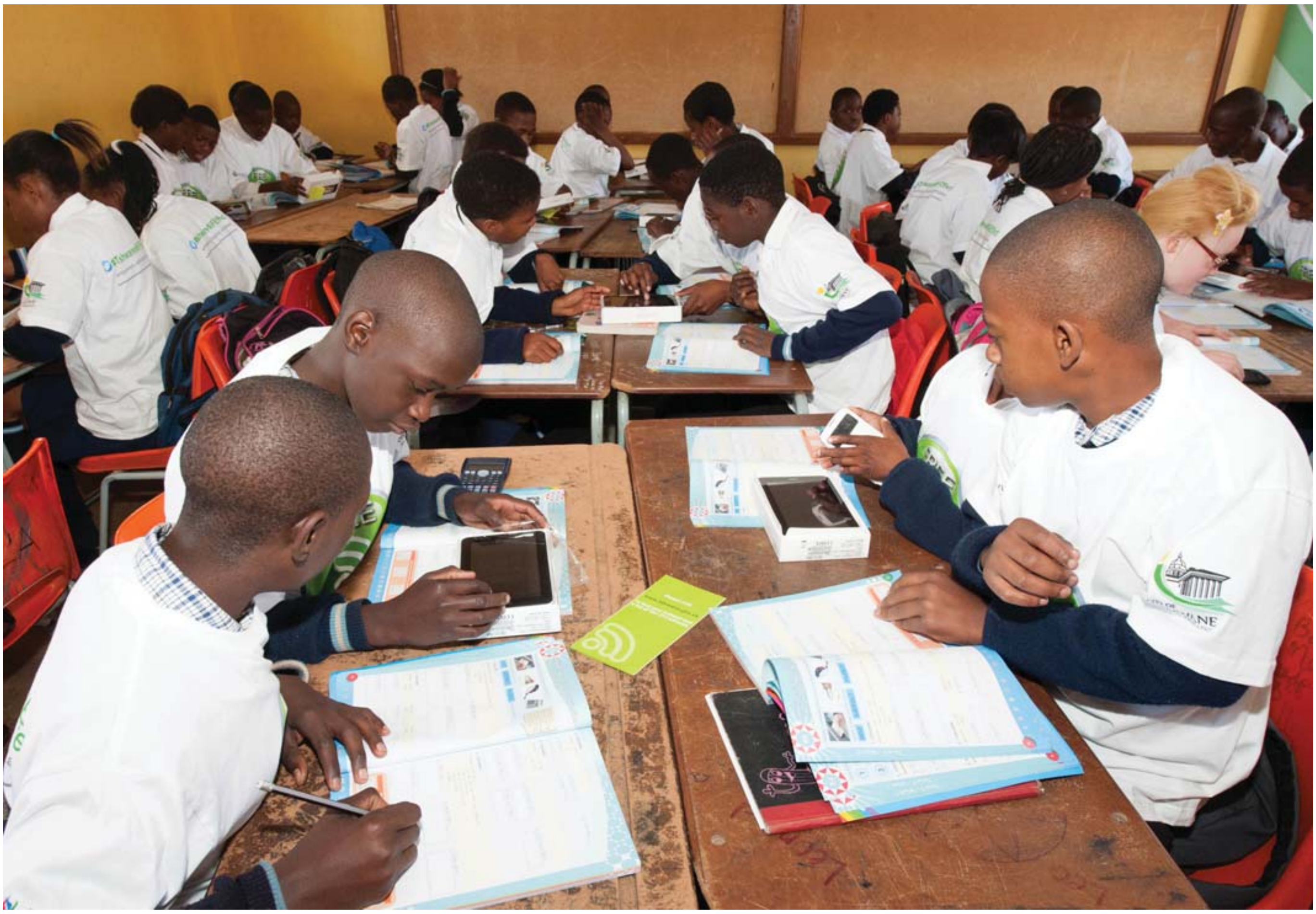
Mergence's involvement in the Tshwane free WiFi project was to provide long-term capital for the insulation of the network and therefore support businesses that are aligned with the investment objectives of its institutional clients. The investment allows Isizwe to accelerate the WiFi roll-out by funding the interim outlay of capital necessary to speed up deployment while allowing the flow of money from the municipality to proceed as agreed outcomes are achieved.

Most importantly, the funding significantly reduces the risk for the municipality, enabling a demonstrable shift towards an outcomes-based procurement model.

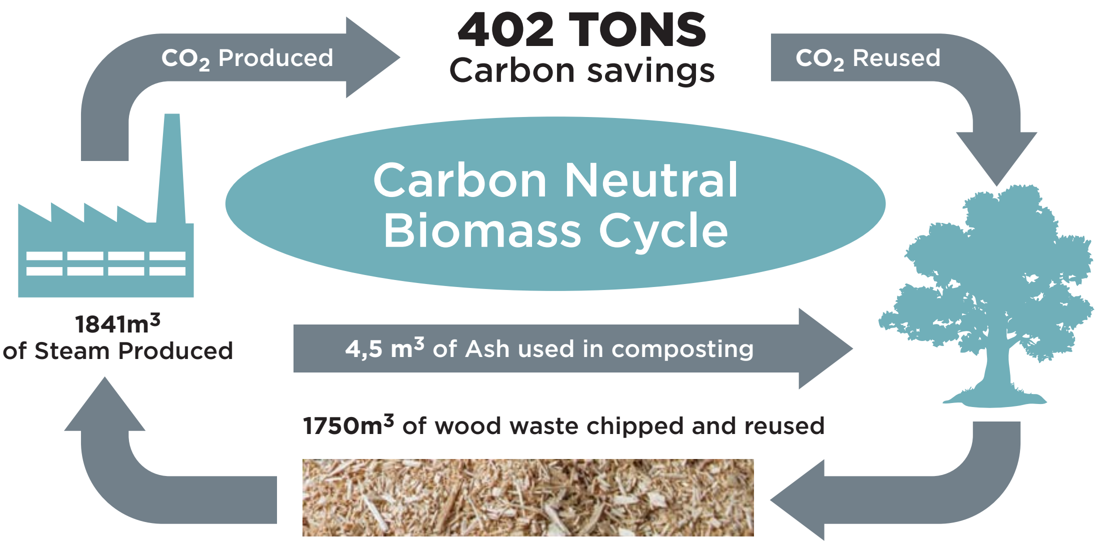




Job seekers and learners
benefiting from free WiFi access



Between 15 May and 15 September 2015



Infrastructure

Sustainable Heating

In 2015 Mergence provided funding to a business that successfully uses biomass fuels to provide green energy solutions to corporate clients.

Sustainable Heating (Pty) Limited is a company producing steam, hot water and hot air from renewable fuels. It delivers comprehensive solutions to its customers' heating, steaming, and incinerating requirements using technologies such as biomass boilers fuelled by wood-chips or organic waste.

Sustainable Heating provides a full outsourcing solution for green heat production to clients amongst which the Pioneer Foods Group (Sasko), Novus Holdings and Dairy Day (a dairy factory in KwaZulu Natal).

It partners with clients to help them with engineering, procuring, constructing, operating and maintaining heating and steaming systems. Its solutions reduce both heating costs and carbon footprint.

Sustainable Heating is financed by the IDC, Mergence and CEO Paul Gorremans. The IDC and Mergence performed full due diligence on each project financed.

Benefits of the business model:

- It allows the client to focus on its core business, and provides significant cost savings on the heat production.
- It reduces the carbon impact of the client.
- It provides the client with best-in-class technology without capital expenditure on their side.
- Sustainable Heating has its own chipping facility and has tied in long term wood supply contracts with some of the biggest and most reliable suppliers.
- It allows production security since biomass fuel is reasonably available and not significantly influenced by global trends.
- Rather than the traditional model of selling equipment and making a once off margin, the energy supply model allows consistent and reliable partnership with clients.

Biomass fuels

When compared to alternative fuel sources, biomass energy resource has many advantages such as greater resource capacity, less sulphur and ash content. Biomass is by definition renewable and the carbon produced by its combustion is reused by the next generations of trees to grow.

It has however some less favourable aspects such as a higher and more variable water content, lower unit thermal output which means larger volumes are required to produce the same heat and higher costs on storage and transportation. Nevertheless, these disadvantages can be overcome with proper planning and use of specialised technology. Biomass resources can therefore be used efficiently as a source of fuel.

Sustainable Heating uses woodchips and sunflower husks as a biomass fuel source for its heating systems. The main advantage is that woodchips are not only renewable but readily available in the form of bio waste and "off-cuts" from industrial woodworking processes (wood mills, furniture manufacturers, etc).

- Sustainable Heating received an award in 2015 for its installation in the Western Cape from the 100% Green Initiative.
- By the end of 2015, the company's operating contracts represented a stretch of at least 500km liquid carbon savings.

Paul Gorremans, Founder of Sustainable Heating, mentions that there are numerous benefits of the newly constructed biomass steam plant in KwaZulu-Natal, which operates on woodchips as opposed to fuel or paraffin. *"Through the biomass facility, we will see an approximate 218 000 tons of carbon reduction over 15 years. The plant is 85 - 90% energy efficient, with fuel only being used to transport the woodchips".*



Housing

Communicare

Communicare is the oldest social housing Non Profit Company (NPC) in South Africa.

In 1929 a group of concerned citizens including pioneers like Zerilda Steyn, William Mason and Bishop Lavis decided to form a Section 21 company to help address the huge housing crisis in South Africa. Originally named The Citizens' Housing League Utility Company, the aim was to provide housing opportunities for the poor and to "represent a spontaneous sympathetic desire on the part of citizens to take a share in the colossal task to promote the human touch and to bring in the new factor of private monetary assistance".

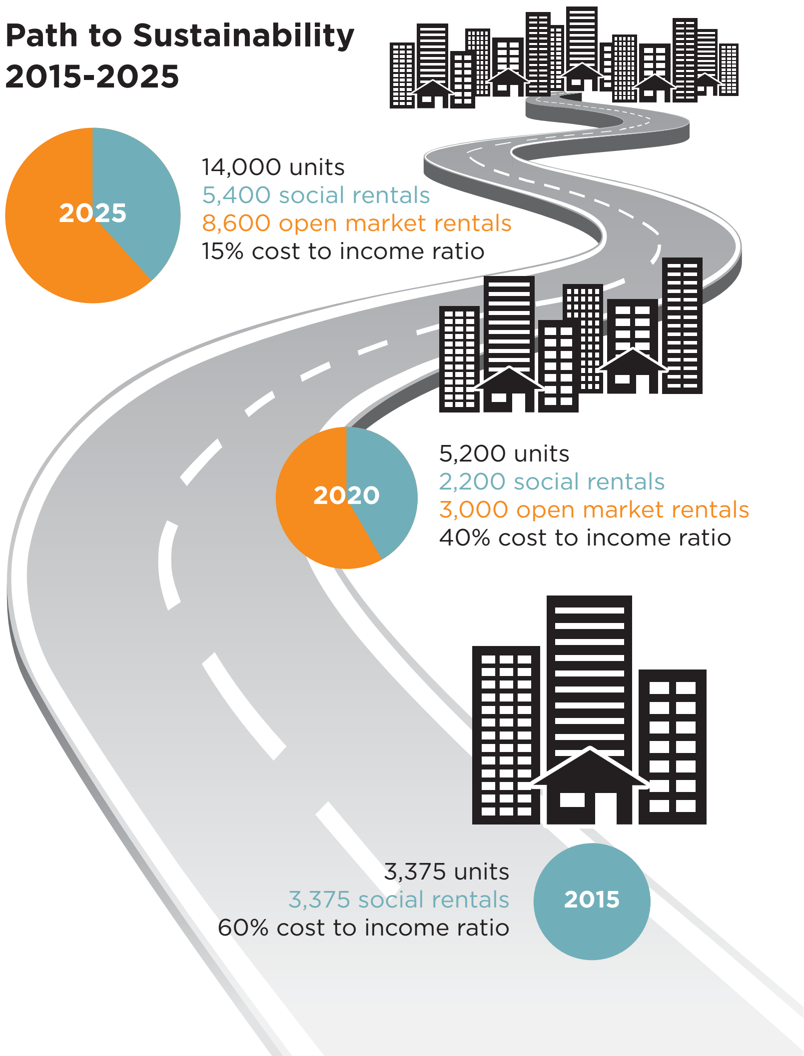
The Citizens' Housing League Utility Company was renamed Communicare in 1990. Since its inception the organisation has left a deep imprint on the landscape of the Cape Peninsula. For many the company offered the only opportunity they had to own a house of their own. For others it was the rare chance of gaining access to affordable, quality, accessible rental accommodation where they could raise a family with dignity.

The Communicare by-line "Building homes and communities" further demonstrates this commitment as also articulated in the new Communicare vision to "create affordable housing by creating integrated sustainable communities".

Communicare now owns and manages 3,600 rental units in well located areas.

Mergence has initially invested via senior debt relating to two Communicare properties, Drommedaris in Brooklyn and Bothasig Gardens Property in Bothasig.

Path to Sustainability 2015-2025



Vision 2025

Their sustainable portfolio of properties will provide affordable accommodation to over 10,000 households whose lives are transformed through their tenancy with Communicare.

By including a substantial rental portfolio in the open market Communicare will be able to provide subsidised accommodation to over 1,000 people reliant on the Old Age Pension Grant.

Communicare's social rental complexes will be places in which families and communities thrive and where people can pursue their own development.

Affordable living spaces
throughout the Western Cape

Wind turbine on Dassiesklip,
near Caledon

Mergence High Impact Debt Fund

Managed by: Mark van Wyk

Head: Unlisted Investments, Portfolio Manager

As Head of Mergence Unlisted Investments, Mark is responsible for overseeing all activities across the unlisted credit and unlisted equity asset portfolios. His career spans more than 16 years in the capital and investment markets. He started his career in property asset management at Sanlam Properties. Mark served his articles at PricewaterhouseCoopers in Cape Town, specialising in structured finance and financial services where he qualified as a chartered accountant. He then spent six years at Mettle Investments, a corporate finance and financial services boutique, where he specialised in corporate finance, structured finance, specialist income funds and private equity transactions.

Mark joined Mergence in 2010. He spent five years as portfolio manager of the Renewable Energy Debt Fund and the Mergence High Impact Debt Fund. In 2014, Mark received the ABSIP Award for Best Alternative Asset/ Fund Manager.

GIIRS RATINGS & ANALYTICS for Impact Investing

What's the news?

*The Mergence High Impact Debt Fund received a **Gold 4-Star** GIIRS rating.*

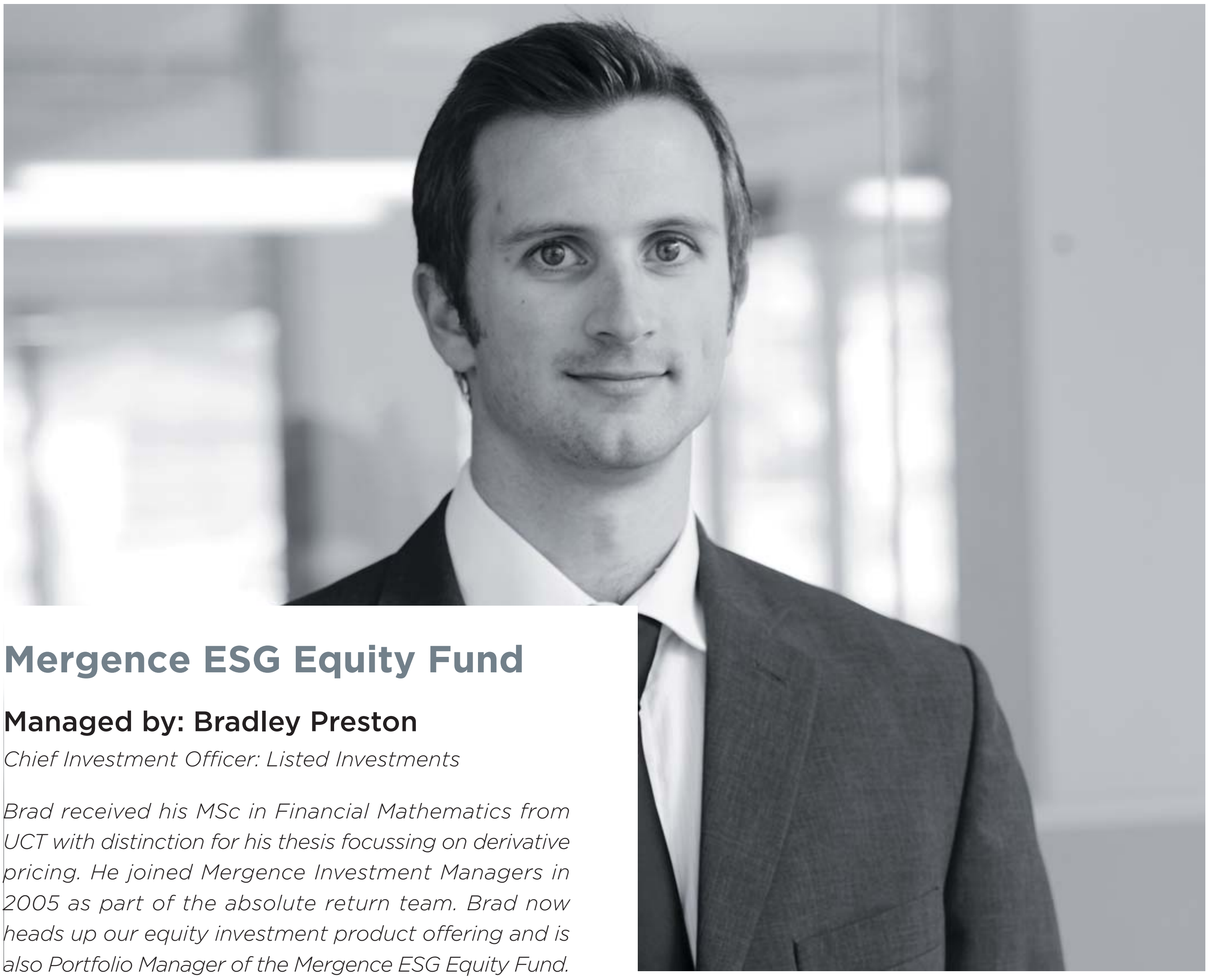
The Mergence High Impact Debt Fund, managed by Mark van Wyk, invests via debt in mainly unlisted companies that create a positive social and/or economic impact beyond the financial return. The investments are targeted into sectors identified in the National Development Plan Diagnostic Report (the precursor to the National Development Plan), which include education, health, housing, enterprise development and transport.

In July 2015, the fund was announced as a "Gold 4-star Rated GIIRS Fund", one of only two South African funds rated by GIIRS.

GIIRS is an international organisation specialising in measuring impact investing, that is investing which seeks not only to produce a financial return but also to make a positive social and economic impact.

The GIIRS rating process involved close scrutiny of the investee companies within the High Impact Debt Fund, each of which was rated individually following completion of a questionnaire and interviews.

The investee companies also are able to find value in the GIIRS rating process via the comparable performance data they received upon completion in their individual Company Ratings Report and Improve Your Score tool which highlights specific practices they can implement to improve their social and environmental performance.



Mergence ESG Equity Fund

Managed by: Bradley Preston

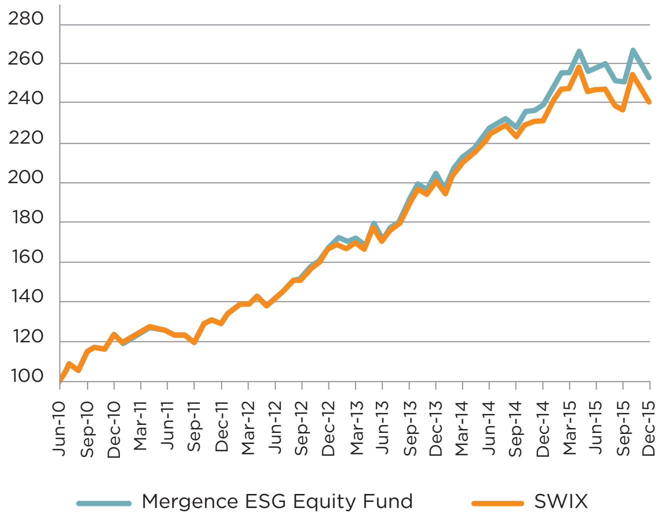
Chief Investment Officer: Listed Investments

Brad received his MSc in Financial Mathematics from UCT with distinction for his thesis focussing on derivative pricing. He joined Mergence Investment Managers in 2005 as part of the absolute return team. Brad now heads up our equity investment product offering and is also Portfolio Manager of the Mergence ESG Equity Fund.

The **Mergence ESG Equity Fund** is a specialised product within the Mergence equity investment framework which incorporates and takes into account all environmental, social and governance issues when evaluating listed securities. This Fund aims to produce measurable impact against its benchmark, the FTSE/JSE Shareholder-weighted Index (SWIX).

The Fund has an estimated average emissions intensity of 40.4 tons of CO_2 emissions per million Rand of revenue compared to an average intensity of 52.9 tons for the benchmark. This translates to a 24% reduction in CO_2 emissions relative to the SWIX.

The adjacent cumulative graph depicts the Mergence ESG Equity Fund's return relative to the SWIX since inception to 31 December 2015.



What's the news?

In 2015 Mergence produced a Sustainability ESG Report for its clients. A summary excerpt follows below as a way of illustrating how an ESG ethos extends across everything that Mergence does whether we are investing in unlisted vehicles or listed equities.

Mergence's ESG framework integrates ESG issues into the investment analysis and decision process with the view of mitigating overall portfolio risk and/or making a constructive impact where warranted. The purpose of integrating ESG factors is to enhance the analysis of all investments by explicitly taking ESG issues into account, promoting improving standards of practice, and assisting the investment process to mitigate any ESG risks to potential or existing loans or investments.

We believe that investment processes may profitably and suitably include the analysis of ESG factors in the assessment of investments. ESG factors may be utilised on both:

- **Economic grounds** (e.g. well governed companies tend to be less risky; companies with sustainable environmental or labour policies will be less risky), and/ or
- **Social grounds** (e.g. tobacco is damaging to the health and welfare of the nation; road transport is beneficial for national development).

The application of such ESG analysis and screening is defined by our clients' expressed preferences and/or guidelines. Where these are absent, we exercise our best judgement as a fiduciary to reduce risk and achieve targeted returns while concurrently aiming to create positive social impact. At all times the fund's asset allocation or investment strategy is geared towards ensuring that satisfactory risk adjusted returns are achieved. The dual goals of maintaining principles of sound portfolio management and achieving meaningful ESG outcomes remain important aspects of the investment process.

ESG forms an intrinsic part of our investment ethos and of our investment approach. It is embedded in our investment process as follows:

- Regular carbon screening and update of listed companies
- Conscientious proxy voting in the best interest of our clients, taking into account ESG issues
- Active engagement with companies (by letter or in person) on ESG matters as appropriate
- It inherently forms part of our qualitative risk assessment and scoring in determining the business risk of a company and thus its bearing on the working cost of capital (WACC)

Mergence is a signatory to the UN Principles for Responsible Investment (PRI) and endorses the Code for Responsible Investment in South Africa (CRISA).

Please contact Ronel Bantjes on ronel@mergence.co.za or 021-433-2960 for a full copy of the 2015 Sustainability ESG Report.

Mergence SRI Fund

Managed by: Mark van Wyk

Head: Unlisted Investments, Portfolio Manager

What's the news?

*During 2015, the **Mergence SRI composite fund** reached a five-year milestone.*

The **Mergence SRI Fund** was launched on 16 June 2010 and consists of a combination of two other funds:

- **The Mergence High Impact Debt Fund** enables investment into impact projects whilst creating real returns for pension fund members. Our fund provides unlisted debt finance to businesses that have a demonstrable social impact and generate a sound risk adjusted return. These businesses are evaluated through a formal due diligence process that is based on a private equity evaluation approach.
- The **Mergence ESG Equity Fund** is a specialised product within the Mergence equity investment framework which incorporates and takes into account all environmental, social and governance issues when evaluating listed securities. This fund aims to produce measurable impact against its benchmark, the FTSE/JSE Shareholder-weighted Index (SWIX).

Five-year track record

At end December 2015 the Mergence SRI Fund had delivered 12% annual compound growth, a performance in excess of an equivalent balanced fund of CPI+5%. See the performance graph below.

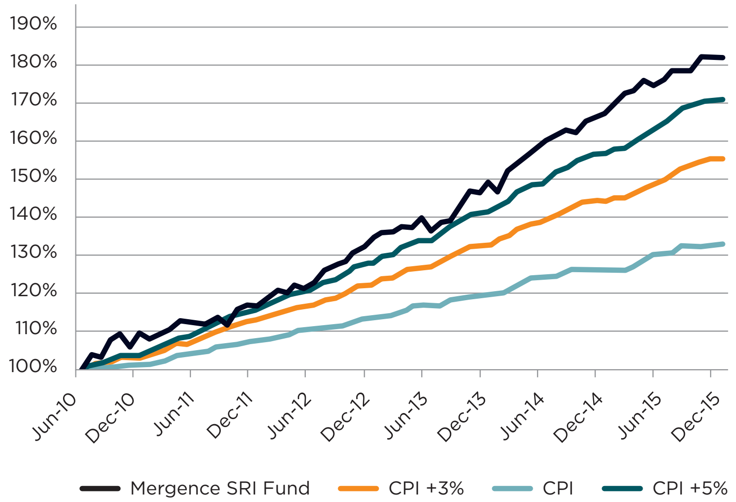
Making up this performance were the **Mergence ESG Equity Fund** which has delivered 20% since inception and the **Mergence High Impact Debt Fund** which has returned 9% over five years, beating its benchmark of CPI+3%.

Table: Summary of Mergence SRI Fund's periodic returns as at 31 December 2015:

	2 Years	3 Years	5 Years	Since Inception[1]
Mergence SRI Fund	8.37%	10.52%	10.60%	11.41%
Benchmark (CPI + 3%)	7.77%	8.29%	8.53%	8.23%
Outperformance	0.60%	2.23%	2.07%	3.18%

[1] Inception: 16 June 2010

Graph depicting cumulative returns of the Mergence SRI Fund since inception to 31 December 2015:



Supporting developmental and infrastructure growth over the past five years

Mergence Renewable Energy Debt Fund

Managed by: Mark van Wyk

The Mergence Renewable Energy Debt Fund was launched in 2013. It invests in renewable energy generation projects which utilise proven technologies. These projects generate and supply energy with the Department of Public Enterprises (DPE) led Renewable Energy Power Producers Procurement Programme (REIPPPP). Investments are made in debt instruments issued by project companies for construction and operation of power plants. Revenues from the generating asset's earnings are passed through to the investors.

Investments take place through renewable energy project companies to maximise profit and isolate specific risks. The fund aims to invest in projects which are structured to deliver socio-economic targets in excess of the minimum thresholds, therefore taking into account local content, local procurement, local ownership and job creation.

What's the news?

1. All 12 Mergence investee projects relating to the REIPPPP commissioned and selling electricity into the grid.
2. Mergence provides key Smalls REIPPPP Project funding
3. Socio-economic highlights

1. Status in words and pictures:

Launch date:	April 2013
Number of invested projects:	12 Projects
Total investment value:	R977m, fund NAV = R1 235m
Status:	All completed, commissioned and selling electricity into the grid
Split between solar and wind:	64% solar, 36% wind

Performance of the Mergence Renewable Energy Debt Fund since the launch in March 2013 to 31 December 2015:

	Mergence Renewable Energy Debt Fund	Jibar + 3%	Outperformance
1 Month	0.83%	0.78%	0.04%
3 Months	2.53%	2.33%	0.20%
6 Months	5.12%	4.67%	0.46%
1 Year	10.42%	9.40%	1.01%
2 Years	10.40%	9.22%	1.18%
Since inception	10,07%	8.98%	1.09%

Noblesfontein: NC
8% Fund allocation

Soitec: Touwsriver, WC
8% Fund allocation

Herbert: Douglas, NC
9% Fund allocation

Dassiesklip: Caledon, WC
8% Fund allocation

Witkop: Limpopo
9% Fund allocation

Kalkbult: De Aar, NC
8% Fund allocation

Van Stadens: Port Elizabeth, EC. 8% Fund allocation

Greefspan: Prieska, NC
3% Fund allocation

Soutpan: Limpopo
6% Fund allocation

Kouga: Oyster Bay, EC
4% Fund allocation

Solar Capital 3: De Aar, NC
18% Fund allocation

Solar Capital 1: De Aar, NC
10% Fund allocation

2. Mergence provides key support to Small independent energy bidders

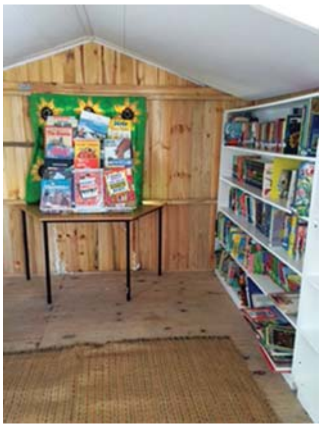
The Small Projects Independent Power Producers Procurement Programme (SPIPPPP) is an important part of the overall REIPPPP, designed to boost small business and ensure their involvement in the overall renewable energy plan.

Two hundred megawatts will be secured from small projects under the SPIPPPP, each with a maximum contracted capacity of 5 MW, allocated over four bid submission phases/windows.

Ten preferred bidders in the first bidding round were announced in October 2015. Energy Minister, Minister Joemat-Pettersson highlighted that the contribution of these projects goes beyond clean renewable electricity to the broader national development objectives, including economic development, social upliftment, job creation, broad based economic empowerment and development of new smaller participants into the energy sector.

The 10 preferred bidder projects comprise six solar photovoltaic (PV), and two each for wind and biomass technologies.

Mergence, together with the Industrial Development Corporation, stepped up to fulfil their development and enabling role by providing a simplified finance package to five of the successful bidder projects amounting to around R833 million.


3. Socio-economic development highlights

Rural communities benefitting from educational spend initiatives.



Sunedison Soutpan (Limpopo area) spend helps to **decrease school absenteeism** among local school children in winter months.

1300 children will receive school shoes and jerseys, while 8400 children will receive books.

Solar Capital assists the previously disadvantaged community of De Aar with **free community WiFi.**

20 hot spots installed - 14 locations in schools, and the rest in public places.

To date, expenditure on the free WiFi initiative is R745 000.

Kouga Wind Farm has among its many projects the **Healthy Mom & Baby Clinic** which specialises in the treatment of pre and postnatal care for women, infant care and nutrition as well as education.

Current expenditure on this project is R403 236.

Comment: Peta Chennells

Senior investment analyst

"Mergence saw an opportunity to provide long-term funding in an area where funding at the time was not readily available while continuing Mergence's commitment to stimulate growth and job creation across the Renewable Energy value chain.

By collaborating with institutions like the IDC and AfD, and drawing on its experience of providing close to R1bn of senior secured debt under the main REIPPP programme, Mergence has been able to secure more opportunities for its institutional investors to participate in investments like these that closely match their investment horizon at attractive returns.

We look forward to working with the developers, the Department of Energy and our co-investors to take these projects to financial close over the coming months".

Solar Capital installed a **computer laboratory** and equipped the Community Training Centre in De Aar.

Training needs being addressed: Basic computer training, entrepreneutial development, Excel, basic web design, etc.

Current expenditure on this project is R700 000.

Metrowind's Eye Testing Program. The Masibonisane campaign came into being with a vision by PPN (Preferred Provider Negotiators) to ensure that all previously disadvantaged children in South Africa have access to an optometric evaluation to identify any special needs, thereby enhancing their education through good sight.

Kouga Wind Farm also built **The Sand Primary School** entirely for primary school children from the community of Umzamowethu.

R616 307 has been spent to date.

Mergence Infrastructure & Development Fund

Managed by: Kasief Isaacs & Mark van Wyk

Kasief Isaacs joined Mergence in February 2015 to bolster the private equity capabilities of the unlisted investments team, and was previously a director PwC's Advisory Services business. He is a qualified Chartered Accountant with a specific focus on the energy industry. He previously led PwC's South African Renewable Energy practice and has advised developers, investors and EPC contractors from South Africa, Spain, Italy, Germany, China and the United States on the SA Renewable Energy market. This includes participation in the REIPP programme, project acquisitions, private PPA's and BEE structuring funding.

The **Mergence Infrastructure & Development Fund** was launched in 2015. The mandate of this fund enables us to invest in unlisted equity and mezzanine debt opportunities. Through this fund Mergence invests in industries where it has strong prior experience mainly in: energy, transmission, transportation, healthcare and other micro-infrastructure. The geographical focus for the Mergence Infrastructure & Development Fund is the entire Common Monetary Area (predominantly, South Africa). See pages 8-10 for recent investments by the Fund.

What's the news?

Article: The case for infrastructure investing

Mark van Wyk (Head: Unlisted Investments) and **Kasief Isaacs** (Portfolio Manager: SADC unlisted)

Governments around the world are looking to private funding to contribute to economic and social infrastructure development, be this rebuilding aging infrastructure or building it from scratch, such as in large parts of Africa. Whereas foreign direct investment is needed in many African countries, South Africa is in a unique position to source funding locally given the depth of its financial markets and a R3 trillion long-term savings pool.

More information and understanding of the asset class is needed in order for trustees to make allocations to infrastructure. This short article presents the case for infrastructure investing and invites trustees to read and ask more.

The case for now

The macro-economic environment in South Africa is suited to the infrastructure investment asset class, characterised slow economic growth and relative low historical inflation levels with a bias to increase in the near future. In this environment, trustees could look to inflation-linked bonds, real estate - and infrastructure asset class.

In addition to the right macro-economic environment, we have a regulatory enabling environment in the form of Regulation 28 and the Infrastructure Development Act. Furthermore South Africa also has experienced local fund managers and competitive management fees.

Further to this, benchmarking and a track record are developing for asset class. According to Credit Suisse Asset Management, adding infrastructure to an institutional portfolio improves the return per unit of risk, measured by a higher Sharpe ratio *("Can infrastructure investing enhance portfolio efficiency?").*

Even the assets are ready, with government stating it has 654 "shovel-ready" programmes waiting for implementation. The renewable energy programme has been highly successful and provided the model for how infrastructure projects can work.

As outlined above, the case for investing into infrastructure as an asset class is compelling - and yet allocations are frustratingly low.

At Mergence, we believe there is some urgency around the need for investment into infrastructure. We believe the National Development Plan needs to be implemented; infrastructure development not only creates jobs and boost economic growth, but it also builds communities and creates a better society into which members can retire. There is also the merit of investing in assets that have a positive economic spinoff, as improving infrastructure should help boost GDP growth.

What should trustees do?

The first step to making an allocation to infrastructure for funds is to determine what role infrastructure should play within the portfolio. Once the Investment Policy Statement has been amended to adjust for the expanded investment universe, a holistic look at what particular role infrastructure should play can help determine how to invest in the asset class. Areas to emphasise while making these decisions involve alignment of interests with managers, assessment of the management team's depth and breadth, and ensuring moderate limits on asset leverage. We generally advise our clients that infrastructure allocations are suitable for pensioner and active portfolios.

In meeting their aim of matching long-term liabilities to assets - and considering broader societal needs - we strongly encourage boards of trustee boards to find out more and consider infrastructure investment in their allocation choices. *(continued overleaf)*

The benefits can be summarised as follows:

Stable cash flows - infrastructure assets provide essential services. Demand is inelastic and therefore there is a very stable return stream.

Diversification - risk premiums and inflation protection characteristics provide low correlation to other major asset classes.

Inflation protection - asset incomes are regulated or predetermined at the investment stage.

Attractive long-term returns - median net internal rates of return for most unlisted funds range from mid-teens to low 20's.

Low sensitivity to GDP - compared to other asset classes, infrastructure has a low sensitivity to changes in GDP due to inelastic demand and price insensitivity.

Mergence solution

Globally, there has been significant discussion about the role that institutional investors may play in funding government-supported infrastructure. Since the Global Financial Crisis in 2008, funding from traditional sources of financing in the infrastructure sector has been constrained due to punitive regulatory risk capital changes. This creates an opportunity for institutional investors to invest in the infrastructure market at competitive investment returns.

Mergence believes that the market in infrastructure investments is continuing to grow and will provide a suitable environment to make new investments in the future. Furthermore, it provides a compelling alternative investing avenue for longer-term institutional investors like pension funds. The demand for infrastructure has mainly been driven by the following factors:

a. Increasing water scarcity
b. Increasing need for energy security
c. Rise of the middle class in emerging markets and rapid urbanisation
d. Historic underinvestment in infrastructure
e. Changing patterns of energy demand & supply
f. New social infrastructure for changing demographics

In response to the increasing demand on infrastructure investment, Mergence Investment Managers has established the Mergence Infrastructure and Development Fund. The Fund has been structured as an open-ended fund, investing in unlisted equity and

mezzanine debt of infrastructure and developmental assets. The fund focusses on building a diversified portfolio of infrastructure and developmental assets that will meet the objectives of supporting economic growth and infrastructure development while yielding sound returns to its investors.

The Fund provides an opportunity for investors to participate in Public-Private Partnerships (PPPs) and other related types of financing/investment transactions to develop socio-economic infrastructure assets such as renewable energy plants, social housing, student accommodation, schools, energy efficient programmes, hospitals and prisons, etc.

The Mergence Infrastructure and Development Fund is targeting a return of CPI + 7% over a rolling 3-year period. These enhanced returns are possible through

(i) our active management and involvement in the investments and

(ii) optimising any ensuing economies of scale across the investment portfolio.

Dipula Income Fund

Chief Executive Officer: Izak Petersen

Izak is the co-founder of Dipula and is a qualified Chartered Accountant. He was previously employed at Deloitte and at PSG Investment Bank. After a short stint at a boutique structured finance and asset management company in Cape Town, Izak co-founded the Mergence Group. Izak has served and continues to serve as an executive committee member of various industry bodies. He currently holds directorships in various Mergence-related companies.

The **Dipula Income Fund** invests in retail, office and industrial properties and is substantially invested in retail properties in underserviced areas throughout all the provinces in South Africa. The Fund was listed on the JSE in 2011 as a result of a successful private equity venture and has grown to a current value of approximately R7 billion in property assets.

"The property meets Dipula's strategy of acquiring ***quality retail assets in targeted areas****".*

Izak Petersen,
CEO of Dipula Income Fund

Case study:
Gillwell Taxi Retail Park, East London

A 2015 highlight for Dipula Income Fund was the successful completion of the R326 million Gillwell Taxi Retail Park development in the East London CBD. The Gillwell mall is unique in that it integrates public transport and retail in a manner never before seen in East London.

Following a much-anticipated opening in November 2015, the 22,260m^2 three-level shopping centre, developed for Dipula by Isibonelo Property Services and Eris Property Group, is rapidly formalising the area's currently dispersed retail offering into a one-stop modern centre.

The development is located at the main transport hub of East London, intended to provide a convenient shopping experience for the customer. In partnership with the city, which has fully endorsed the project, improvements will be made to the roads around the centre, enhancing the CBD even further.

In addition to this, the centre caters for hawkers who have been allocated stands and trading spaces inside the centre, thus integrating their businesses for more sustainable trading in much improved conditions safe from the sun and rain. The centre is home to the largest taxi rank in East London, covering various routes. For the first time commuters, from mainly lower LSM's and previously disadvantaged areas, can jump out of a taxi and shop leisurely in a clean and inviting environment. The taxis are paramount to the success of the centre as they will bring most commuters from various parts of East London including numerous surrounding towns as far away as the former Transkei.

Anchor tenants include Game and Shoprite. Over three quarters of the tenant mix is made up of national retailers.

The centre is also located within walking distance from all key government departments, which serve the local metropolitan area as well as the region. It is nearby the local train station, buses, harbour and the world-renowned Mercedes Benz factory - the largest employer in East London.

The centre will also serve the growing student population of nearby educational institutions including the University of Fort Hare, Nelson Mandela Bay.

> ***"This was an interesting project*** *from an engineering perspective given the steep fall of the site but at the end we managed to come up with a design that meets all requirements and will blend well with the CBD whilst being an iconic addition to East London".*
>
> Izak Petersen, CEO of Dipula Income Fund

WALK THE TALK

Mergence has a Sustainability Policy which covers all our business operations and endeavours to reduce the impact of our business activities on the environment to the minimum. We have a management programme in place which extends to the areas of property and facilities, corporate buildings and facilities, energy, waste, carbon footprint and procurement. The programme includes but is not restricted to:

- **Reduction in carbon emissions**
- **Responsible energy and water consumption**
- **Recycling and waste management**
- **Procurement from sustainable sources**

Targets are defined and we will start reporting on our progress externally in the 2017 Impact Report.

We further believe that these factors contribute to a sustainable business:

- **BEE ownership & management**
- **Employment Equity**
- **Graduate Training Programme**
- **Skills Development**
- **Occupational Health & Safety**

Our approach to business is guided by commitment to the principles of leadership, inclusivity, transparency, integrity, stewardship and continuous improvement.

We also believe we have the power to make a positive human impact on the diverse people we touch.

Our attention to environmental, social and economic responsibility includes working within the law and voluntarily exceeding legal requirements in order to be innovative and demonstrate leadership on the issues that are important to us and our stakeholders. As an investment management company, we have an opportunity to advise clients and make considered investment decisions in line with our fiduciary duties that support sustainable development and the growth of a restorative economy.

First intake in 2015 of our Graduate Training Programme

LOOKING FORWARD

Despite being pioneers in impact investing in South Africa, at Mergence we feel we are only just getting started!

The need for infrastructure development is massive – not only in our country but within sub-Saharan Africa as a whole.

Stakeholders can expect to hear about some exciting innovations in 2016. Among other sectors, we see opportunities in water, renewable energy and biomass projects.

We are also likely to extend our focus to include more private equity and look forward to communicating with you in this regard.

The Mergence Team

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