

**STATEMENT BY FIDELIS MADAVO** [REDACTED]

**TO**

**JUDICIAL COMMISSION OF ENQUIRY INTO ALLEGATIONS OF IMPROPRIETY REGARDING  
THE PUBLIC INVESTMENT CORPORATION (PIC)**

**21 JANUARY 2019**

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## Information on Person Making Statement

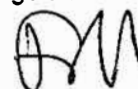
1. I, Fidelis Madavo, confirm that I am an adult male aged 59 bearing identity number [REDACTED] and reside at [REDACTED]. The contents contained in this statement insofar as they relate to the Public Investment Corporation SOC Ltd (PIC) are to the best of my knowledge and belief, true and accurate.
2. I was employed by the PIC during February 2007 and have been in its employ since then with uninterrupted service and have held various titles entailing certain responsibilities. I am currently employed as the Executive Head: Listed Investments and report directly to the Chief Executive Officer of the PIC.
3. My qualifications include a Bachelor of Science in Chemical Engineering (BSC Hons) (University of Wales), MSC Industrial & Administrative Sciences, (City University, London) and International Executive Development Program (Wits & London Business Schools).

## Background Information

4. I have been requested by the Evidence Leader of the Judicial Commission of Enquiry into Allegations of Impropriety regarding the PIC to submit a statement which details the investment process adopted and implemented by PIC relating to transactions concluded in its listed investment portfolio.
5. The Listed Investment Portfolio comprises the following divisions: Internally Managed Listed Equity; Externally Managed Funds, Fixed Income and Dealing.

## Context to Listed Investments Division

6. PIC invests funds on behalf of its clients. Broadly, the mandate covers listed equities, listed fixed income securities, cash and money markets, unlisted property, unlisted equity and unlisted debt. The Listed Investments Division covers the listed equities, listed property, listed fixed income securities, cash and money markets portion of the mandate from the client. Listed investments constitute approximately 80% of our Assets Under Management.
7. In respect of Listed Investments, mandates have been provided by Government Employees Pension Fund ("GEPF"), Unemployment Insurance Fund ("UIF") and



Compensation Commissioner ("CC"), Compensation Commissioner Pension Fund (CP), Associated Institutions Pension Fund (AIPF) and other smaller clients.

8. Transactions concluded by the Listed Investments Division would be dealt with through the following governance committees: in line with the Delegation of Authority (DOA) of the PIC:
  - 8.1 Portfolio Management Committee (Listed Investments PMC-LI)
  - 8.2 Investment Committee (IC)
  - 8.3 PIC Board (as appropriate)
9. The members of the PMC-LI currently include the following:
  - 9.1 the CEO (Chairperson of PMC)
  - 9.2 the CFO
  - 9.3 the Executive Heads: Risk, Legal, Research and Project Development and Investment Management
  - 9.4 the Executive Head of Listed Investment division, The General Managers of Internal Equities, Externally Managed Funds & Internal Fixed Income
10. There may be circumstances where proposals will be referred to the PIC Board and/or the client.
11. There are various instruments in place which provide a framework for undertaking listed investments. These include the client mandate, policies, processes and guidelines, delegations of authority and governance structures.

#### **Investment Process Listed Investments**

12. Below is a description of the investment process as it relates to the Listed Investments Division of PIC. It will make reference to certain committees in certain instances, it is suggested that the investment process be read in conjunction with the Terms of Reference applicable to the relevant committees of PIC as well as the DoA in so far as it relates to Listed Investments.

#### **Approach to Portfolio Management and Rebalancing**

13. The internally Managed Portfolio is managed via two distinct strategies namely, Passive and Enhanced Beta.



14. The Passive strategy replicates the stock weights of the client mandated benchmark by periodically rebalancing the portfolio. It thus has a very small tracking error i.e. deviation from the benchmark.
15. The Enhanced Beta portfolio is also managed using a client mandated benchmark. However the stock weights may differ slightly (within certain risk parameters) to the benchmark. The stock tilts or weights in this fund are based on the Research process outlined below. There are therefore trades that are made in order to rebalance the fund to reflect the research views of the investment team. However, the tracking error of this fund remains below that of one that would be defined as an active fund.
16. In compliance with FSCA regulation, investment decisions including trading are made only on publicly available information.
17. In instances where the listed team is exposed to non-public information, the stock is immediately embargoed.

**Investment Process: Listed Equities (Internally Managed)**

18. We believe that Financial Markets are inefficient due to behavioral biases which cause discrepancies between a company's fundamental value and its market price.
19. We believe that a strategy of purchasing quality companies at attractive valuations outperforms the market over time.
20. We employ a disciplined framework (4-Factor process-see section below on Approach to Fundamental Research) focusing on rational and objective analysis to identify these opportunities and guard against falling victim to behavioural biases.
21. We believe that the empirical evidence of a quality company is one that generates high returns on its invested equity capital at lower than peer group risk. We seek to identify these companies and add them to our portfolio at attractive valuations.

**APPROACH TO FUNDAMENTAL RESEARCH**

22. PIC follows a four factor approach when analyzing stocks. These factors are detailed below:



- 22.1 Factor 1 – **Competitive Advantage /Quality**: To determine the competitive advantage and quality of the company Porters Five Forces framework is used.
- 22.2 Factor 2 – **Stewardship/ESG**: Good corporate governance and adherence to best practices on ESG leads to sustainable returns. We use the reports and scoring done by the ESG team in our analysis and engagement with the Board and Management of companies to ensure that best practices are adhered.
- 22.3 Factor 3 - **Uncertainty / Risk**: This is a measure of how uncertain an analyst is on their Fair value call using operating leverage and financial leverage into consideration. Operating leverage takes into consideration the fixed cost base of the company and what could happen to margins and operating profit if revenues deviated from the projected base case.
- 22.4 Factor 4 – **Valuation**: Our key assumption is that Fundamental (Fair Value) is discoverable. The tools that we use are given below:
- 22.4.1 Discounted Cash Flow (DCF) is the primary tool as it best encapsulates the drivers of a company's fair value
- 22.4.2 Supporting tools include:
- 22.4.2.1 Exit Price/Earnings (P/E) – Sustainable Earnings and a Normalised PE
- 22.4.2.2 Internal Rate of Return (IRR) – Split between Headline Earnings per Share (HEPS) growth, Dividend Yield and Rating change
- 22.4.2.3 Price/Net Asset Value (P/NAV) – May be applicable in unique situations where cash flows attributable to shareholders are not determined

## **DISCUSSION AND DECISION MAKING FORUMS**

Discussion or information forums that aid the portfolio management process on an ongoing basis comprise.

### **23. Morning Meetings**

These meetings occur on a weekly basis and are used to track market developments including results and economic data releases. They are used as red flag generators in that any information that may impact the house view is highlighted at this level with detailed analysis to follow.

#### **24. Deep Dive Meetings**

Once detailed analysis on a stock is done then a deep dive research document is presented to the team using the four factor analysis framework. The merits of the document are researched by the team and a stock call is agreed upon. Periodical updates on the stock are presented when the analyst's view has changed on the company.

#### **25. Sector Focus Meetings**

These meetings are held periodically to discuss the overall sector views.

#### **26. Portfolio Manager Meetings**

These are held on an ongoing basis (ideally weekly) to ensure that the portfolio reflects the views of the team and risk budgets are within the parameters set by the client. The meetings are aimed at ensuring that the monitoring function is carried out properly. From these ongoing meetings, the equity team is always assured that all new market information is properly incorporated into the views that drive the investment stance at any point in time.

#### **VIEW THE MAINTENANCE PROCESS**

27. The last component of the investment process is the Investment view maintenance. This is what each and every team member occupies him or herself with at all times. As market and industry events unfold, new information will arise that will have a direct impact on the team's view. The team members follow such information and keep testing whether or not view generating assumptions still hold. If they do hold in the light of the new information, then no action is taken. If the assumptions are challenged and need changing, then a detailed review of the change and the resultant investment view change is discussed before the change is implemented.

#### **CORPORATE ACTIONS: IPO's, RIGHTS ISSUES, BOOK BUILDS**

28. Transactions that require PMC or relevant governance approval are Initial Public Offerings and Rights Offers (above certain amounts as per the DOA).

29. There are also disposals or sales above certain amounts that may require PMC or relevant governance committee approval as per DOA.

### **Deal Origination/Funding Application**

30. PIC receives applications for funding through various means which could include the following:

- 30.1 Unsolicited applications from clients and/or their advisors
- 30.2 Referrals by other funding institutions
- 30.3 From strategic partners with whom PIC has concluded Memorandum of Understandings such as Industrial Development Corporation
- 30.4 IPOs
- 30.5 Book Builds and Rights Issues

### **Deal Scoping**

- 31. The investment team will prepare the Scoping Report requesting approval to go to Due diligence and submit to the EH for review and approval to submit to Portfolio Management Committee of Listed Investment ("PMC: LI")i via PIC's Company Secretariat.
- 32. PMC:LI will consider the submission and either approve, or decline request to go to due diligence or refer back the submission for rework. If referred back for rework, the investment team will rework and resubmit to PMC:LI. If approved the application will move to due diligence.
- 33. Upon receiving approval from PMC:LI, the investment team will request from the various Executive Heads from Risk, Legal and ESG divisions for resources to assist in the due diligence of the proposed transaction.

### **Due Diligence**

- 34. Depending on whether the investment team or ESG, Legal and Risk has internal capacity to conduct due diligence on the transaction, a decision will be made by the respective teams as to which section of due diligence scope will be outsourced and which section will be done using internal resources.
- 35. If the decision is to outsource, procurement process will be undertaken to appoint the relevant service providers to conduct due diligence on the transaction on behalf of the respective teams.
- 36. The approval of the recommended service provider will be done in line with the DoA. Once the approval is obtained, an engagement letter will be concluded between PIC and the





service provider. The engagement must be reviewed by Legal and signed in line with the DoA.

37. The scope of the due diligence will broadly cover the following areas:

- 37.1 Commercial due diligence
- 37.2 Financial due diligence
- 37.3 Technical and operational due diligence (as appropriate)
- 37.4 Legal and regulatory due diligence
- 37.5 Environmental, social and governance due diligence

38. Following the above, investment team will prepare an Appraisal Report recommending either approval or decline of the application. The appraisal document will be reviewed and signed off by the EH of Listed Investments prior to submission to PMC:LI. The Appraisal Report may have only minor additions to the Scoping Report depending on the type of deal.

39. The Appraisal Report will be accompanied by independent reports from ESG, Risk, and Legal divisions and these reports will incorporate the due diligence findings and the controls to be implemented to mitigate the risks identified during due diligence. These reports are reviewed and signed off by the EH of those respective divisions prior to submission to PMC:LI via the Company Secretariat.

40. PMC:LI will consider the submission and either approve or decline the request or refer back the submission for rework. If declined, the investment team will prepare a decline letter to be signed in line with the DoA. If it does not fall within the PMC:LI DoA, the transaction will be approved for onward submission to a higher committee. This higher committee usually would be either the Investment Committee ("IC") and/or Board depending on the DoA.

41. If the transaction falls within PMC: LI DoA, PMC:LI will approve the transaction.

- 41.1 PMC: LI approves
- 41.2 Company Secretariat prepares the resolution for sign off by the Chair
- 41.3 The team prepares an appraisal letter for submission to potential client.

42. There will be differences in the process followed for Book Builds, Rights Issues due to real time nature of listed market events. For most of these, the investment team will execute in line with the prevailing DoA and thereafter notify PMC as per DoA.

#### **Structured Investment Products (SIPS)**

43. SIPS is part of the Private Equity (PE) division. Transactions may be executed by this team using listed investments, usually to facilitate BEE funding. In undertaking these transactions, it is important to maintain strict Chinese wall between the Listed Investment team and the PE team, so that the Listed team is not in possession of non-public information.

#### **EXTERNALLY MANAGED FUNDS**

44. The Externally Managed Funds Division (“EMF team”) has a dual mandate within the PIC of alpha generation (as the satellite portion of client investments) and to play a transformational role within the South African investment management industry.
45. The EMF team aims to construct solutions on behalf of clients that consistently add alpha (i.e. returns in excess of the client benchmark) over the long term in-line with client expectations, through robust portfolio construction processes while being aware of client risk tolerance.
46. The team aims to contribute to the broader social and economic development of South Africa through allocation of capital to black-owned asset management firms, supporting black-owned stock brokers and increasing participation of black individuals within the industry.
47. To achieve these objectives a diligent investment process is followed. The EMF team’s investment process aims to create outcomes that deliver in all phases of the market cycle by utilising diversified investment strategies (i.e. alpha sources) and working with external investment managers, who individually represent the best skills in their respective areas of specialisation.
48. The externally managed funds Investment Process comprises of 3 key areas viz External Manager Selection, Portfolio Construction and Monitoring, each with a clear investment process.

### **External Manager Selection Process**

49. The External Manager Selection Process provides a framework for governing the selection of managers and initiates the process for capital allocation.
50. The External Manager Selection Process starts with external investment manager identification, followed by the Due Diligence Process, which incorporates independent ESG, Risk and Legal evaluations at initial and final evaluation stage, with recommendations by these divisions to the relevant governance committee.
51. External Investment Manager Identification is the process of shortlisting external investment managers who meet technical criteria set by the team. The process is done through Request for Proposals (RFP) or a Screening Process as done by the EMF team.
52. Prospective external investment managers who meet PIC minimum requirements are requested to complete a Due Diligence questionnaire which highlights the details of their firm as it relates to the Organization and its People, Investment Philosophy and Process, Resources within the business, Risk Management and Portfolio Construction Processes etc.
53. The responses to the Due Diligence questionnaires are scored by a Technical Evaluation Team and prospective external investment managers with a score above the required threshold will be notified accordingly that an on-site visit to verify the information in the document will be performed by the Technical Evaluation Team. This team will comprise members of the EMF, ESG and Risk divisions and will be supported by Legal, Procurement and Internal Audit.
54. The on-site PIC Due Diligence visit is undertaken to evaluate and validate the information obtained from the questionnaire. It further provides the Technical Evaluation Team the opportunity to view and assess systems described in the documents as well as to meet the prospective Investment team and other key individuals in the business.
55. The on-site Due Diligence visit is followed by another round of scoring. Prospective external investment managers with a final score above the required threshold are placed on the PIC approved database of external investment managers.



56. Further quantitative analysis (including portfolio construction) is performed by the EMF team before a recommendation of allocation is made to the PMC Listed Committee. Submissions are also made by the ESG, Risk and Legal divisions. If required by the Listed Delegation of Authority, approval will be sought from the Investment Committee and submission will be made to the Investment Committee following PMC: LI recommendation.
57. Upon receipt of the relevant governance Committee approval, the prospective external investment managers who are recommended to be allocated funds will receive notification letters from the PIC and contracting process will begin – facilitated by the Legal division.

#### **Manager Monitoring and Retention Process**

58. The objective of the monitoring program is to identify on a timely basis any adverse changes in the external investment manager's organization, investment process, or performance results. Once these adverse changes have been identified, the monitoring program also dictates the manner of the PIC's response.
59. Quarterly sessions are scheduled for interaction, while the PIC team visits the external investment manager's primary place of business once a year – taking the form of an on-site Due Diligence.
60. The monitoring process requires both desktop analysis of quantitative information as well as frequent meetings with external investment managers to discuss business issues, investment strategy and performance results, in person or via teleconference.

#### **Course of Action as a Result of Irregularities and underperformance**

61. Depending on the significance of an event, the EMF team can choose one of four possible courses of action: take no action and continue to monitor, recommend placement of the external investment manager on probationary status known as the watch list, conduct a comprehensive study known as an in-depth review, or recommend termination of the external investment manager.

#### **Portfolio Construction Process**

62. The Portfolio Construction process is the optimization process that ensures that skilful external investment managers are allocated to in an optimal way. The weight that an



external investment manager has in a solution is related to the strategy that they execute on and their contribution to risk and return in the blend of external investment managers.

63. The process is done with awareness of the benchmark and cognisance of client objectives – i.e. risk and return targets.

## **FIXED INCOME**

64. The Fixed Income Division manages the majority of Bonds and Money Market Instruments in-house.
65. Potential issuers arrange a meeting with the General Manager (GM) and/or Executive Head: Listed Investments to inform the Public Investment Corporation (PIC), of a new proposed fixed income instrument to be issued.
66. At the meeting PIC is informed, by the lead arranger / issuer, of the details of the issuer / guarantor as well as tenor, coupon rate and characteristics of the proposed bond issuance.
67. The Fixed Income (FI) team then do a desk top analysis to ensure the bond complies with the minimum client mandate requirements and check the credit rating of the issuer. If the bond / issuer passes these checks, the FI team present the potential transaction / issuer to the Portfolio Management Committee (PMC-L), to request a full due diligence.
68. The due diligence undertaken includes the Credit team, Risk, Legal as well as the ESG teams (similar to 37).
69. On receipt of the independent reports from the different teams, the FI team goes to a second PMC (L), where the relevant governance Committee's approval is requested in order to be able to invest in the specific bond and / or issuer.
70. Once such approval is granted, the FI team will look at the different bond mandates and portfolios in order to determine the proposed allocation. The FI team then participates in the primary auction or book build. If the outcome is successful, and an allocation of bonds is received, detail such as allocation, static data (ISIN, Maturity Date, Yield etc.) is obtained from the book runner (counterparty). The transaction is then booked to the relevant portfolios, matched with the counterparty and settled on settlement date.

71. Thereafter the FI team continuously manages / monitors the exposure relative to client mandate parameters and restrictions. Re-aligning the portfolios, in-line with the Fixed Income strategy, client mandates as well as the relevant benchmark, as and when required.



**FIDELIS MADAVO**

**EXECUTIVE HEAD: LISTED INVESTMENTS**

21.1.19

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DATE