Edcon sale: Bain's R664m soft landing

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As Edcon, SA's largest clothing retailer, laboured under a crippling R25bn debt and battled to pay its suppliers, private equity company Bain Capital managed to suck out more than R664m in "consulting fees" over its eight years as Edcon's owner.

Bernie Brookes.

Picture: Freddy Mavunda

This illustrates that while Bain may have lost its initial R6.4bn investment in Edcon, which it made as part of the landmark private equity deal struck in 2007, the consulting fees paid to the Boston-based firm certainly would have cushioned the blow.

The Edcon debacle has become a cautionary tale for private equity buyouts. The debt burden meant Edcon ceded market share until finally Bain threw in the towel in September, handing control of the company to its debt holders and walking away.

Edcon CEO Bernie Brookes has said that Bain walked away with "nothing".

But the Financial Mail's analysis of the "related party" deals in Edcon's annual reports show that the money payable to Bain over the years amounted to R4.2bn. This includes a R5.5bn loan to Edcon in 2008, which ballooned to R9.1bn with interest. It remained unpaid, though R8.3bn of the loan was recognised as equity in 2012, suggesting it was a "payment in kind loan" common in these deals.

However, Bain was paid R664m in consulting fees, as well as a share of R5bn in preference dividends paid to shareholders.

A source close to Bain, who declined to be named, said its staff had spent more than 75,000 hours working to turn the retailer around.

However, the payment for the consulting fees for the 75,000 hours — which the Financial Mail is told was well below "normal consulting rates" — works out to R8,587/hour.

This apparently paid for the fees of Bain officials, as well as transactional "services" to Edcon.

Jean Pierre Verster, a portfolio manager at Fairtree Capital, says this is a common tactic of private equity firms. "It is a known potential conflict in the private equity world that [these] firms also charge consulting fees to the companies their funds have invested in, which is a bit of a perverse incentive seeing that it would be a cost from the perspective of the company or fund, but income for the private equity firm."

When asked, Bain refused to shed much light on these payments, other than to stick to its script that it had been a "patient shareholder" of Edcon, which had "continuously supported it through a very tough trading environment".

Bain said it had invested more than R6.4bn in capital into Edcon — three times the level of investment before it took control in 2007.

"Bain Capital also spent extensive man-hours on the ground with Edcon over the years of its ownership, and ultimately facilitated the capital restructuring so cash could flow into growing the business henceforth," it said.

Edcon refused to comment. But insiders at the retailer said they believed these consulting fees were "usual for private equity", and Bain didn’t really make money out of this — it simply covered its costs.

The amount of cash that flowed back to investors in Bain’s Fund IX, which holds the Edcon investment, isn’t clear.

Source: Financial Mail