

AFRICA RISK CONSULTING

South Africa Monthly Briefing December 2019

South Africa Summary 20 December 2019

President Cyril Ramaphosa's (2018-present) first year in office disappoints. Action against corruption, on the economy and on social transformation is slow. The government is defensive, pointing to the Zondo Commission of Inquiry and appointments at the National Prosecuting Authority (NPA). The NPA launches a wave of corruption arrests of serving African National Congress (ANC) officials and former state-owned power utility Eskom senior managers. A new CEO at Eskom reveals the full extent of problems. Experts suggest that corruption at Eskom continues unabated as current bailouts are being misappropriated. The continuing energy crisis and load-shedding hamper the economy, which ends the year in the second quarter of negative growth. An International Monetary Fund (IMF) Article IV report highlights weak economic growth, deteriorating fiscal and government debt and major difficulties in the operations of state-owned enterprises (SOEs) as persistent problems contributing to long-term low growth, unemployment and inequality.

Frustration mounts amid blackouts ...

As all of **South Africa** heads out to start the traditional summer holiday season, the door closes on a momentous but disappointing first year of President **Cyril Ramaphosa's** (2018-present) official presidency. He is seen as moving too slowly for the needs of the population, the economy and for the international business community.

Ramaphosa came to power in his own right after winning the popular poll in South Africa's 8 May election on the back of an **African National Congress (ANC)** manifesto promising economic and social transformation as well as reducing corruption. However, as the year ends, popular frustration has increased as little progress appears to have been made and the economy lurches towards recession for the second time in a year while unscheduled rolling blackouts affect the nation's psyche and add further blows to the economy.

*"The mood is one of increasing frustration. Some things are getting done. Government would argue they are ticking off the problems. South Africans would argue that they are not doing them fast enough."*¹

Uppermost on people's minds is the government's failure to make any substantial progress against 'state capture':

*"Government argues they have made progress. Commissions of inquiry – there have been. This is the first step. But they increase the level of frustration. The airwaves are full of rehashing the corruption and describing in yet more detail what actually happened over the last 10 years. The big problem is the [National Prosecuting Authority] NPA, which has not brought charges against the key perpetrators."*²

The government's response is to point to what it has done to end state capture:

- appointed the **Zondo Commission of Inquiry into Allegations of State Capture**;

¹ Tim Cohen, Business Editor, Daily Maverick

² Tim Cohen, editor Business Maverick, 19 Dec 2019.

- appointed **Shamila Batohi** as a new credible head of the NPA, untainted by South African politics, having served as a prosecutor at the **International Criminal Court** until her appointment as NPA head;
- Batohi in turn appointed four of the country's top legal minds to prosecute state capture crimes, namely **Wim Trengove SC, Hamilton Ngwako Maenetje SC, Geoff Budlender SC** and **Tembeka Ngcukaitobi**.

Part of the problem is that Batohi has to manage an NPA that a decade of political interference under President **Jacob Zuma** (2009-2018) left hollowed out. The departure of some 700 lawyers has left the NPA working at 70% of its former capacity.³ Moreover, Batohi is reportedly determined to be sure that her cases will stand up in court before issuing arrest warrants.

But, as one journalist reported, South Africans are impatient and most eager for the *"Ladies and Gentlemen - we got him"* moment – referring to the **United States (US)** capture in **Iraq** of the late dictator, President **Saddam Hussein** (1979-2003), and in South Africa's case the arrest and repatriation of the **Gupta** brothers. The Gupta brothers were central to the grand corruption committed under Jacob Zuma and are currently living in **Dubai (United Arab Emirates)**. South Africa and Dubai have agreed an extradition treaty but it has yet to be ratified.

NPA launches first of a wave of anticipated arrests

The NPA's approach has been slow and steady in order to be certain of convictions. Investigators arrested **Bongani Bongo**, formerly security minister under president Jacob Zuma, on 21 November. Bongo was charged with attempting to bribe an official to obstruct investigations into theft at state power utility Eskom. Days later, the NPA won a court judgement to freeze the assets of **Regiments Capital**, a company accused of orchestrating corrupt deals linked to the **Guptas**. On 19 December came the first major corruption arrest linked to Eskom.

The NPA arrested on charges of fraud, corruption and other offences two former senior Eskom officials, **Abram Masango** and **France Hlakudi**. **Tubular Construction** CEO **Tony Trindade** and former chair **Mike Lomas** are alleged to have paid bribes of R30m (\$2.11m) to Masango and Hlakudi as part of a R1.2-billion (\$84.3m) contract for work on Eskom's problem-ridden **Kusile** power station project. Hlakudi was Eskom's contracts manager for Kusile while Masango was the state-owned enterprise's group executive for capital projects. He oversaw key contractual processes at Kusile and Medupi.

Trindade and Lomas face charges of corruption, and allegedly made corrupt payments to entities and accounts that Hlakudi controlled.⁴ Tubular, along with fellow Kusile contractors **Stefanutti Stocks, Esor Construction** and **Tenova Mining and Minerals**, reportedly paid R75m (\$5.27m) to a private company account, **Babinatlou Business Services**, which was an apparent slush fund for Hlakudi and some of his former Kusile colleagues. The NPA has also arrested **Maphoko Hudson Kgomoeswana**, Babinatlou's sole director.

Tubular was initially appointed as a second-tier sub-contractor in 2009 to help construct the air-cooled condensers (ACCs) at Kusile's six power generation units. **France**-headquartered **Alstom** held the main contract for the ACC works. Tubular had been contracted by one of Alstom's sub-contractors. However, with the help of Hlakudi and Masango in 2015 Eskom replaced Alstom with Tubular as the main contractor for the ACC work at three of the six units, securing the R1.2 billion contract.

Business reels as economy goes into reverse amid load shedding

The NPA arrests point to South Africa's second problem marked critical in Cyril Ramaphosa's in-tray since he came into office – Eskom, the state-owned power company. The full extent of the impact of state capture on South Africa is manifest in Eskom.

³ The Economist, 14 Dec 2019

⁴ Daily Maverick, 19 Dec 2019.

With Eskom now under new CEO **André de Ruyter**, the full extent of the problems at the utility is becoming apparent. What the NPA arrests go some way to demonstrate is the level of corruption at the state-owned entity, which power sector experts say goes far deeper than just the executive teams. Power experts question whether the Eskom corruption has been stopped:

“We are talking about the technocrats being involved in everyday corruption. Eskom has been bailed out but much of the money that is meant to have been spent on maintaining is leaking, being spent on the wrong things or just not being spent on fixing and maintaining the power stations and the grid. The main problem is power stations – the grid itself is still robust.”⁵

Eskom’s problems are likely to continue. The old power stations are breaking down repeatedly because of failing maintenance regimes:

*“Properly maintained, even the old generators will work. At **Majuba** – the newest of the old generators, the coal supplies caught fire. Whether this is ineptitude or sabotage, the impact is the same. Things are going wrong with the old stations all the time. Majuba is 30 years old but not 50 or 60 – so properly maintained, it should be able to deliver to the grid. But with the two new plants there cannot be the excuse of lack of maintenance. They are new. This then says something is seriously wrong in their construction.”⁶*

Low risk that the grid may collapse, but nevertheless a risk

Despite the chaos at Eskom, energy experts state that there is little likelihood that the grid will collapse. They report that South Africa’s grid is among the most robust in the world and that the company has been able to keep a close eye on the mismatch between supply and demand and use “load-shedding” – a structured programme where supply is cut to certain areas to ease demand pressure on the grid. However, Eskom’s crisis means it is unlikely to be able to manage a crisis provoked by an unscheduled event – such as a major climate change event. A severe mismatch between supply and demand could cause the grid to collapse entirely, which could take several days to recover, and cause a knock-on social crisis in hospitals, schools, air traffic control and industry.

During December, two major mining companies, **Sibanye-Stillwater** and **Petra Diamonds**, were forced to shut after Eskom imposed what it calls stage six load-shedding. Eskom had instituted an emergency shut down to remove 6,000 megawatts of power from the grid after a series of breakdowns in its power plants. Neither company could risk sending miners underground in the event of a power outage.

Eskom underlines a further issue in South Africa’s political ideology. Ramaphosa has repeatedly stated Eskom is “*too vital to [South Africa’s] economy to be allowed to fail*”. Yet his government is not prepared to countenance private sector competition for Eskom. With the impact of load-shedding on mining output, mining companies have come round to the idea of developing their own energy supplies and feeding surplus into the grid.

And so the government continues to inject funds into a failing state-owned enterprise. This year alone it had to provide two bail-outs totaling some \$20 billion. At the same time, the national regulator rejected the company’s plea for a 15% annual tariff increase, approving a 9.41% increase. With the population and the economy unable to sustain the increases directly, it has been done through the fiscus. The bailouts mean that the company now accounts for \$30 billion of South Africa’s debt – equivalent to 9% of GDP.⁷ This has added to fears that US-based rating agencies **Moody’s** and **Fitch** may downgrade South Africa’s debt to junk, forcing mass disinvestment from the country.

⁵ Private Equity Energy sector expert

⁶ Private Equity Energy Sector expert

⁷ Financial Times

The economy ends the year pointing at recession in 2020

The impact on the economy of repeated load-shedding is becoming apparent. The economy posted negative growth in the 3rd and 4th quarters, ending the year pointing to recession for the second time since Ramaphosa came to power.

The state of the economy overpowers everything. It dictates the mood of both the political environment, the mood of the citizenry and that of the private sector. In response government is apologetic, defensive – sometimes with reason.”⁸

An **International Monetary Fund (IMF)** Article IV report on 25 November highlighted that if the country continues with its current policies, the outcome will be the opposite of what Ramaphosa promised when he assumed power. The IMF says low growth and low job creation will exacerbate unemployment, poverty and inequality. The IMF report highlighted three persistent problems:

“Persistently weak economic growth. Subdued growth is largely attributable to stagnant private investment and exports and declining productivity, mainly due to the slow pace of reform to address weaknesses in the business climate, including regulatory constraints, labour market rigidities, and inefficient infrastructure. Unreliable electricity supply has exacerbated the growth constraints. Small and medium-sized enterprises (SMEs) are especially disadvantaged in this environment.

Deteriorating fiscal and government debt. Weak revenue and increased current expenditure have worsened the budget composition, and raised deficits and borrowing requirements, undermining the sustainability of public finances. This fiscal trajectory has also lifted financing costs across the economy.

Major difficulties in the operations of state-owned enterprises (SOEs). Inefficiencies in SOEs operating in network industries such as electricity and transport, translate into costly inputs for businesses, and repeatedly require financial support from the fiscus.”

Planner

14-16 Jan 2020 **(South Africa) South African Reserve Bank** (central bank) Monetary Policy Committee (MPC) Meeting;

2-6 Feb 2020 **Cape Town (South Africa)** Investing in African Mining Indaba;

17-19 Mar 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;

Apr 2020 **(South Africa)** Opposition party **Democratic Alliance** Federal Congress;

19-21 May 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;

21-23 Jul 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;

15-17 Sep 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;

17-19 Nov 2020 **(South Africa) South African Reserve Bank** (central bank) MPC Meeting;

2021 **(South Africa)** Municipal elections;

2024 **(South Africa)** General election

⁸ Tim Cohen, Business Editor, Daily Maverick

Chronology

19 Dec 2019 **Johannesburg (South Africa)** *Daily Maverick*. **National Prosecuting Authority (NPA)** arrests senior state-owned power utility **Eskom** employees **Abram Masango** and **France Hlakudi** on charges of fraud, corruption charges relating to R30m (\$2.1m) that **Tubular Construction** CEO **Tony Trindade** and chairperson **Mike Lomas** paid to Masango and Hlakudi linked to a R1.2 billion (\$84m) **Kusile** power station contract;

17 Dec 2019 **Johannesburg (Gauteng Province) (South Africa)** *Financial Times*. Mining companies **Sibanye-Stillwater** and **Petra Diamonds** close in response to Eskom “stage six” load-shedding which removed 6,000 megawatts of power from the grid;

8 Dec 2019 **Johannesburg (South Africa)** *The South African*. State utility company **Eskom** says planned power outages will continue for a week, citing “unplanned breakdowns” and dire diesel shortages as reasons for the ongoing outages;

6 Dec 2019 **Johannesburg (South Africa)** *South African Airways (SAA) press release*. An independent business rescue practitioner, **Les Matuson** from **Matuson Associates**, has been appointed to lead SAA’s voluntary business rescue process;

5 Dec 2019 **Johannesburg (South Africa)** *CNN*. Public enterprises minister **Pravin Gordhan** announces “voluntary business rescue” plan for troubled national airline **South African Airlines**, in which it will receive over \$136m from existing lenders ahead of the rescue and another \$136m at a later date through the national treasury;

5 Dec 2019 **Johannesburg (South Africa)** *BusinessTech*. A special parliamentary committee on land expropriation agrees to publish its new draft bill, which will change the constitution to allow for land expropriation without compensation, in the government gazette next week;

4 Dec 2019 **Johannesburg (South Africa)** *Business Day*. Ruling **African National Congress** party candidate **Geoff Makhubo** is elected mayor of **Johannesburg**, replacing **Herman Mashaba** of opposition party **Democratic Alliance**;

4 Dec 2019 **Johannesburg (South Africa)** *Nasdaq*. **Johannesburg Stock Exchange** data shows foreign investors have ditched more than \$9.6 billion of **South African** stocks and bonds this year, the most significant annual selloff in at least a decade;

4 Dec 2019 **Johannesburg (South Africa)** *SABC*. President **Cyril Ramaphosa** instructs government to urgently put failing state-owned national airline **South African Airlines** into a business rescue plan;

2 Dec 2019 **Johannesburg (South Africa)** *Business Day*. A **Competition Commission** study finds that data prices are too high and its head, **Tembinkosi Bonakele**, says **Vodacom Group** and **MTN Group** must agree to reduce tariffs by a further 30% to 50% within two months or face sanctions;

2 Dec 2019 **Johannesburg (South Africa)** *News24*. **South African Airways** tells government that it cannot finalise its annual financial statements until government provides equity or loan guarantees;

29 Nov 2019 **Johannesburg (South Africa)** *News24*. **Pietermaritzburg High Court** dismisses former President **Jacob Zuma**’s leave to appeal against his corruption trial related to a 1990s arms deal;

29 Nov 2019 **Johannesburg (South Africa)** *Business Day*. Two large travel insurance companies, **South Africa-based Travel Insurance Consultants** and **Australia-based Flight Centre Travel Group**, stop covering tickets issued by **South African Airways** against insolvency;

27 Nov 2019 **Johannesburg (South Africa)** *Business Day*. **South African Reserve Bank** (central bank) deputy governor **Kuben Naidoo** says if **Moody’s Investors Service** cuts the country’s credit rating to junk there could be a selloff of between \$5-8 billion of its bonds;

25 Nov 2019 **Johannesburg (South Africa)** *CNBC*. An **IMF** report predicts that on current policies, **South Africa's** medium-term growth outlook would remain subdued, accompanied by muted inflationary pressures;

25 Nov 2019 **Johannesburg (South Africa)** *Reuters*. **United Kingdom**-based mining company **Vedanta Resources** warns that it will process its zinc ore elsewhere unless **South Africa** can fix its power problems;

25 Nov 2019 **Harare (Zimbabwe)** *EWN*. **South Africa**-based retailer **Pepkor Holdings** says it will exit **Zimbabwe** after an economic crisis in the country hurt its performance.

22 Nov 2019 **Johannesburg (South Africa)** *BusinessDay*. **United States**-based ratings agency **S&P Global** downgrades its outlook for **South Africa's** credit rating to negative, citing weak pace of economic growth, mounting government debt burden and liabilities related to energy utility **Eskom**;

22 Nov 2019 **Johannesburg (South Africa)** *BusinessDay*. **South African Airways** agrees with trade unions to a 5.9% pay rise to end an eight-day strike;

22 Nov 2019 **Johannesburg (South Africa)** *News24*. Industry official say authorities have begun blocking arms sales to countries including **Saudi Arabia** and the **United Arab Emirates** in an inspections dispute;

20 Nov 2019 **Johannesburg (Gauteng Province)** *Daily Maverick* The **South African Revenue Service (SARS)** obtains warrants of execution to seize two luxury vehicles and other moveable property owned by former **Prasa** boss **Lucky Montana** in its claim of R1.8m (\$126,447) in unpaid and overdue taxes.

18 Nov 2019 **Johannesburg (South Africa)** *Daily Maverick*. **National Prosecuting Authority (NPA)** prepares cases against **Regiments Capital** and its owners in a bid to secure more than R1 billion (\$70.25m) identified as the alleged proceeds of crime linked to the company's dealings with state-owned entities;

18 Nov 2019 **Johannesburg (South Africa)** *Daily Maverick*. **Kim Davids**, private secretary to former public enterprises minister **Lynne Brown**, resigns in the wake of revelations about her staying in a **Dubai** hotel courtesy of the **Guptas**;

About Africa Risk Consulting:

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