

## AFRICA RISK CONSULTING

### South Africa Monthly Briefing January 2015

---

#### South Africa Summary 28 January 2015

*The government pays \$564m to South African Airways and \$870m to Eskom as private sector investors steer clear of the country's state-owned enterprises (SOEs). The public purse suffers as a result of high levels of debt and mismanagement by political appointments in the boardroom. President Jacob Zuma (2007-present) sends the controversial amended Mineral and Petroleum Resources Development Act back to parliament citing constitutional concerns. The minerals sector reacts positively and seeks to remove clauses that could allow the government to compulsorily acquire up to 50% of new concessions. South Africa's anti-corruption mechanisms destabilise further with the suspension of the police services' Hawks investigation unit director, Anwa Dramat, and the resignation of Special Investigations Unit director Soni Vas. Looting of over 150 shops in Soweto reveals social tensions between South Africans and migrants and raises questions over growing nationalist sentiment.*

---

#### Government pays the price for failing SOEs as the private sector steers clear

The government is once again using public funds to rescue mismanaged state-owned enterprises. The treasury confirmed on 21 January that it would provide an additional \$564m in state guarantees to **South African Airways (SAA)**.<sup>1</sup> The **African National Congress (ANC)** government came to SAA's aid after the airline's auditors told SAA they could not finalise its accounts without the guarantee. In December President **Jacob Zuma** (2007-present) moved the responsibility for SAA from the department of public enterprises to the treasury, ostensibly because its problems were of a financial, rather than an operational, nature (see *ARC South Africa December 2014 Briefing*). Faced with this new responsibility and the real possibility that the airline could be forced to declare bankruptcy, the treasury had little option but to bail it out again.

This new debt relief guarantee is in addition to the existing \$683m guarantee already in place, bringing the total amount the government has pledged to underwrite to \$1.25 billion.<sup>2</sup> The treasury has laid strict conditions on the debt underwrite. SAA has 90 days to provide the treasury with a credible action plan to overhaul its network structure, fleet strategy and airline structure. This is likely to include existing plans to sell off parts of the airline's business including **SAA Technical**, profitable subsidiary **Mango**, and catering supplier **Air Chefs**.<sup>3</sup>

The problems at SAA are linked to poor management and political appointments at the top. The airline's board has still not reinstated its CEO **Monwabisi Kalawe** after chairperson, and close Zuma ally, **Dudu Myeni** suspended him without a reason in November 2014 (see *ARC South Africa December 2014 Briefing*). A board meeting in December at the end of Kalawe's 30 working day suspension period was supposed to rule on his return to work. However, the airline has so far not taken any action. Kalawe was brought in to oversee the financial turnaround in November 2013 but has spent much of his time as CEO in conflict with Myeni and other board members.<sup>4</sup> Public enterprises minister **Lynne Brown** had been putting Myeni under pressure to reinstate Kalawe but the transfer of responsibility for the airline to the treasury has limited Brown's influence.

---

<sup>1</sup> Business Day, 21 Jan 2015

<sup>2</sup> Business Day, 23 Jan 2015

<sup>3</sup> Moneyweb, 15 Jan 2015

<sup>4</sup> Rand Daily Mail, 20 Jan 2015

The government is currently seeking an equity partner for the firm. **Etihad** (the **United Arab Emirates'** state airline) has been mentioned as an interested party. However, the new government debt guarantee gives investors one more reason not to invest in the airline.

*"I wouldn't touch SAA with a barge pole...better to back one of its cheaper and better competitors and let it fail."*<sup>5</sup>

There has been some effort on the part of SOEs to set up deals in order to increase outputs and associated profitability. However, international partners have pulled out of these deals when they see the financial situation and managerial problems that many SOEs face. **Malaysian** oil company **Petronas** withdrew from a \$1.5 billion deal with South African petroleum company **PetroSA** to purchase an 80% stake in South Africa-based downstream distributor **Engen** on 17 January. PetroSA had touted the deal as a key part of its expansion plan to purchase petrol stations and expand its liquefied natural gas (LNG) facilities. Extra revenue from the deal was also designated to fund a 360,000 barrel per day refining facility for the **Coega Industrial Development Zone** in the **Eastern Cape**.<sup>6</sup>

Petronas pulled out of the deal due to concerns that PetroSA could not leverage adequate funds. November was the official deadline for the deal and the PetroSA board was pushing for more time. PetroSA is in poor financial shape. The company's distribution and refinery outputs were \$290m lower in 2014 than in 2013 and the company's reserves have almost halved from \$950m in 2009 to \$430m in 2015.<sup>7</sup> There were also concerns over the appointment and the firing of **Tshepo Kgadima** as chairman of PetroSA's board. Kgadima was accused of defrauding investors on a listing for his company **Lontoh Coal** on the **Hong Kong Stock Exchange** (see *ARC South Africa December 2014 Briefing*). The board appointed Kgadima in November 2014 and fired him, following this revelation, in December 2014.<sup>8</sup> Further allegations of mismanagement at the company emerged in January. An independent audit alleged that **Yekani Tenza**, former acting CEO, revised board minutes retrospectively to raise the price of an acquisition in **Ghana's Jubilee Oil Field** from \$480m to \$500m in 2012.<sup>9</sup> The **Pretoria** high court has ordered Tenza to repay PetroSA the \$7.4m he pocketed in inflated costs during his 2011-2013 tenure.<sup>10</sup>

The combination of poor financial status and questionable management increased Petronas' doubts over whether PetroSA would be able to hold up its part of the deal. Investors in other sectors share this opinion:

*"South Africa's SOEs are a poisoned chalice. The massive debt, incompetent political appointments in the boardroom and pressures of public opinion to deliver unattainable results make them an extremely risky investment."*<sup>11</sup>

The government has been trying to encourage SOEs to sell off assets in order to bridge funding shortfalls. However government entities that are profitable are reluctant to sacrifice their own profitability to prop up their failing cousins. National power utility **Eskom** is severely underfunded and has high levels of debt. The result is a grid with barely enough capacity to power the country, and that regularly falls short of demand as poorly maintained power plants regularly malfunction. Load shedding has been at unprecedented levels through December, normally a low demand period due to the warm weather, and has continued into January with Eskom warning that no end is in sight before March.<sup>12</sup>

<sup>5</sup> Source: private equity firm, Johannesburg

<sup>6</sup> Business Day, 13 Jan 2015

<sup>7</sup> Business Day, 13 Jan 2015

<sup>8</sup> City Press, 14 Dec 2014

<sup>9</sup> Mail and Guardian, 17 Jan 2015

<sup>10</sup> Mail and Guardian, 8 Jan 2015, 17 Jan 2015

<sup>11</sup> Source: investment banker, Johannesburg

<sup>12</sup> Mail and Guardian, 26 Jan 2015

The treasury said in October that Eskom would be required to sell off non-essential assets to raise \$1.7 billion in funding required to keep it running through to 2018. This plan suffered a setback in January when the **Industrial Development Corporation (IDC)** announced that it would not sell its holdings in companies listed on the **Johannesburg Stock Exchange (JSE)** to fund the Eskom bailout.<sup>13</sup> The IDC said that in order for it to remain financially independent of the government, it was unable to sell its \$4 billion in shares.<sup>14</sup> The move came after banking company **Barclays** estimated that the government could raise a total of \$7.4 billion from the sale of the IDC's total stakes in listed entities.<sup>15</sup> The treasury announced on 22 January that it would give Eskom a fiscal injection of \$870m from as early as June in order to keep the company solvent throughout the year, effectively reversing their intention not to directly fund the company out of the public purse.<sup>16</sup>

Eskom is trying to raise money on the capital markets to finance gaps in its cash flow. It has approached **Deutsche Bank AG, Rand Merchant Bank (RMB)** and **Standard Bank Group** to help it market bonds. The banks set up meetings with potential investors in four cities in the **United States (US)** from 26 January before moving to **London** on 2 February. Eskom last went to the markets for capital in July 2013 when it managed to raise \$1 billion. However ratings agencies **Moody's** and **Standard and Poor's** have downgraded Eskom's ratings to one notch above junk, making a successful sale unlikely. Rates on the 2013 bond issue, which matures in 2023, have risen 14 basis points to 6.25% in January 2015 alone.<sup>17</sup> The bonds were originally marketed at 6.75%.<sup>18</sup>

*"The one thing that will work in Eskom's favour is the decrease in oil prices which will keep costs of emergency generators down."*<sup>19</sup>

However neither the government's fiscal injection or a successful bond marketing will make a dent in Eskom's \$14 billion outstanding debt or the \$20 billion it needs to upgrade the country's power infrastructure.<sup>20</sup> Eskom has said that it is putting together deals to raise the \$19m shortfall in its funding through to March 2018. However, questions over its future liquidity will remain.

### Zuma sends amended minerals bill back to parliament

President Zuma has not signed the controversial amendment to the **Mineral and Petroleum Resources Development Act 2014** into law, sending it back to parliament on 16 January. The act was rushed through parliament prior to the elections in May 2014 and contained a number of clauses that commentators feared would discourage investors. The proposed amendment gave the mines minister extended powers on oil and gas projects. The minister had power to demand 20% free equity on new projects with the option to purchase a further 30% at a price agreed to with the state, rather than based on market values.<sup>21</sup> This is on top of the 26% stake already reserved for a black economically empowered (BEE) partner.<sup>22</sup>

The official reasons for Zuma sending the bill back were that it elevated a number of minerals industry codes, including the code of good practice, the housing and living conditions standards, and the amended **Broad-Based Socio-Empowerment Charter** to the status of national legislation.

<sup>13</sup> Business Day, 14 Jan 2015

<sup>14</sup> Reuters, 15 Jan 2015

<sup>15</sup> Business Day, 13 Jan 2015

<sup>16</sup> Business Day, 22 Jan 2015

<sup>17</sup> Moneyweb, 23 Jan 2015

<sup>18</sup> Fin24, 29 July 2013

<sup>19</sup> Source: global energy company, London

<sup>20</sup> Moneyweb, 23 Jan 2015

<sup>21</sup> Mail and Guardian, 4 Apr 2014

<sup>22</sup> Mail and Guardian, 16 Jan 2015

Observers and industry figures also voiced concerns in early 2014 that it would clash with South Africa's international **General Agreement on Tariffs and Trade (GATT)** commitments.<sup>23</sup>

*"The reasons given are all correct...but with a stagnant economy the government can't afford to scare off oil and mining businesses."*<sup>24</sup>

Zuma explained that it was necessary for parliament to carry out further public consultation on the bill and to carry out further work with bodies from the mining and petroleum industries. Industry figures have been cautiously positive about the move. **Anglo American CEO Mark Cutifani** said that his company wanted to work with the government to make sure that the concerns of both sides were addressed.<sup>25</sup>

*"We [mining companies] now have a chance to push back...particularly on the equity requirements...and get an amended act we can work with."*<sup>26</sup>

### Change at the top weakens anti-corruption units

South Africa's weak and politically manipulated anti-corruption apparatus has suffered a further blow. Head of the **Special Investigations Unit (SIU)** anti-corruption unit, **Soni Vas** resigned on 26 January citing his wife's illness.<sup>27</sup> Zuma appointed Vas, a well-known and respected figure in the legal community, to head the SIU in July 2013 following a 20-month leaderless spell. Although Vas largely toed the party line and avoided high profile investigations into Zuma and his allies, he at least investigated some of the inflated fees for the refit of President Zuma's rural home, **Nkandla**.<sup>28</sup>

The opposition **Democratic Alliance (DA)** told the press that Vas' replacement is likely to be deputy director of national prosecutions **Nomgcobo Jiba**.<sup>29</sup> Jiba, who is far closer to Zuma than Vas, has had a chequered history at the **National Prosecuting Authority (NPA)**, refusing to take part in internal government probes in the ministry of justice.<sup>30</sup> Vas' resignation creates internal instability at the SIU, which is likely to disrupt current investigations. However, the opportunity for Jacob Zuma to promote an arch-loyalist into one of the anti-corruption units would give him further power to stall probes into his alleged corruption during the arms deal.

*"If Jiba heads the SIU it will become a political tool for Zuma; she does whatever the president tells her."*<sup>31</sup>

The SIU is not the only anti-corruption agency currently undergoing leadership issues. Police minister **Nkosinathi Nhleko** on 23 December suspended the **South Africa Police Service (SAPS)**'s **Hawks** investigation unit director, **Anwa Dramat**, over allegations of his involvement in the illegal rendition of four **Zimbabweans** in November 2010.<sup>32</sup> Dramat appealed against the decision. The Pretoria high court ruled on 23 January that his suspension was *"unlawful and invalid"*. The court also ruled the appointment of Maj-Gen **Berning Ntlemeza**, former police commissioner of **Limpopo**, as acting head of the unit was unlawful. However on 26 January the minister filed an appeal preventing Dramat from returning to work. The DA has accused President Zuma of orchestrating Dramat's suspension due to his repeated attempts to investigate the Nkandla case.<sup>33</sup>

<sup>23</sup> Business Day, 16 Jan 2015

<sup>24</sup> Source: journalist, Johannesburg

<sup>25</sup> Business Day, 16 Jan 2015

<sup>26</sup> Source: mining house, Johannesburg

<sup>27</sup> Mail and Guardian, 26 Jan 2015

<sup>28</sup> Daily Maverick, 27 Jan 2015

<sup>29</sup> City Press, 27 Jan 2015

<sup>30</sup> City Press, 24 Oct 2014

<sup>31</sup> Source: investigative journalist, Johannesburg

<sup>32</sup> Business Day, 24 Dec 2014

<sup>33</sup> Business Day, 30 Dec 2014

Chief prosecutor **Mxolisi Nxasana** is fighting Zuma's allies within the NPA, including Jiba. Zuma has been trying to oust Nxasana since early 2014 but has so far been unsuccessful.<sup>34</sup> This combined with disarray in the SIU and the Hawks means that the only voice speaking out against corruption in South Africa is public protector **Thuli Madonsela**. The hobbling of the rest of the apparatus means that her power to take action against corrupt officials will be further limited.

*"Even if Zuma didn't orchestrate this directly, he encouraged an atmosphere in which this could happen and is happy to sit back and reap the benefits of no consequences for corruption."<sup>35</sup>*

### Looting of foreign-owned businesses in Soweto exposes divided society

Shopkeepers fled to neighbouring parts of Johannesburg after rioters looted foreign-owned shops and businesses in **Soweto, Gauteng Province**. A foreign shop owner sparked the violence when he shot 14-year-old **Siphiwe Mahori** on 19 January. Mahori was part of a group of boys who allegedly tried to rob his store.<sup>36</sup> In the week that followed looters raided over 150 foreign-owned shops in the neighbourhood. The official death toll of the looting stands at five, although the press has reported two more deaths that the SAPS claim are not linked to the looting.<sup>37</sup>

The police and the provincial government have dismissed claims by opposition politicians, diplomats and human rights groups that the attacks were xenophobic. ANC politicians have also been quick to throw themselves into the debate. Regional premier **David Makhura** criticised attacks against foreigners. At the national level, deputy minister in the presidency **Buti Manamela** warned that xenophobic violence could trigger inter-ethnic violence.<sup>38</sup>

The violence calmed down after five days and an extensive police operation but the riots expose a tension within the neighbourhood, and in wider South African society, between South Africans and migrant groups. The **African Diaspora Forum (ADF)** wrote an open letter to Zuma on 26 January claiming that the government's response to the recent violence and to ongoing xenophobic attacks in townships is insufficient. The ADF claims that there have been dozens of xenophobic attacks between 2008 and 2014, representing an increasing trend in xenophobia-motivated violence.<sup>39</sup> It strongly criticises the SAPS and the department of home affairs for encouraging these attitudes by aggressively tracking down illegal migrants.<sup>40</sup>

The government has been courting nationalist policies. The **Immigration Act 2014**, which passed into law in May 2014, changed the immigration status of large numbers of migrant workers effectively limiting the numbers working in the country. It also imposes tougher sentences for overstaying visas and places a burden upon businesses to prove they are unable to find a qualified South African when employing a foreign worker.

*"When times get tough governments want to appease people by making exclusionary policy....but they are playing with fire....when public service provision is poor and the economy is in recession if you encourage nationalism you also encourage xenophobic attacks."<sup>41</sup>*

<sup>34</sup> Daily Maverick, 27 Jan 2015

<sup>35</sup> Source: journalist, Johannesburg

<sup>36</sup> Eyewitness News, 28 Jan 2015.

<sup>37</sup> Mail and Guardian 26 Jan 2015

<sup>38</sup> Daily Maverick, 26 Jan 2015

<sup>39</sup> ADF press release, 26 Jan 2015

<sup>40</sup> ADF press release, 26 Jan 2015

<sup>41</sup> Source: social researcher, think-tank, Pretoria

## Implications

The government is now paying the full price of Zuma's policy of political appointments or 'deployments' to SOEs. The policy sacrificed board level competence to party and Zuma loyalty resulting in consistent mismanagement. The treasury's initial plan had been to sell off non-critical assets. However, the damage of poor financial management, low levels of investment, and infighting at board level has made enterprises like SAA and PetroSA, unattractive to domestic and international private sector partners.

Next month's budget promises to be troubling. The bail-out will punch a hole in the national budget, which is already under pressure from 2014's low growth. Growth prospects are not much better in 2015, which will feel the full effects of rolling power cuts. This risks leaving growth-critical areas, such as education, underfunded in the coming years. Moreover, too much talk of privatisation will anger the unions and the left wing of the ANC. Too much spending, on the other hand, not only takes away from other public services but does little to change the current situation. South Africa's SOEs have swallowed billions of rand in rescue money with little to show for it. The government needs to raise hundreds of billions of rand to resuscitate its infrastructure. Taxation in a slow growth economy with high unemployment and a constant social welfare bill cannot achieve this.

There are signs that the ANC – under the influence of pro-business deputy president **Cyril Ramaphosa** – is aware of the need to attract investment. Zuma's sending back the minerals and resources act carried more weight than his pro-investment speech at **Davos**. Redrafting the act may appease the oil and gas sector but may be too late for the mining sector, which is already reducing its exposure to South Africa following the bruising strikes of 2014. The mining sector still offers plentiful (if badly paid) jobs, and high returns for the government. Concessions from the government to the industry are essential to reverse the disinvestment trend. The South African government's intentions will draw some focus at **Cape Town's** annual pan-African mining convention in early February.

Despite Ramaphosa's apparent influence, South Africa is still in Zuma's control as the changes at the top of the anti-corruption unit show. The DA has brought a corruption case that again directly threatens Zuma, but also provides an incentive for him to foster weak and loyal anti-corruption mechanisms. This leaves domestic and foreign investors without the ability to hold corrupt officials and businessmen to account.

The looting in Soweto is symptomatic of a wider shift in South African society, precipitated by the ongoing economic downturn. During the public service riots of 2012 and 2013 townships rioted against the police and public service providers, but when given groups to blame for their own economic hardship, violence will increasingly turn against non-South Africans. This mirrors trends in **Europe, Asia** and the US, which have all seen an increase in identity-related attacks during times of hardship in the economic crisis. It is unlikely that this will destabilise the nation, but if the ANC seeks to mobilise this political force with nationalist legislation, it poses a legitimate risk to non-South African owned businesses.