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The B&M Weekly Africa Markets Report on the Dow Jones Africa Titans 50 Index Week Ending Friday, November 27, 2009

The B&M Weekly Africa Markets Report is a mere sampling of our more extensive coverage of the 50 securities listed in the Dow Jones Africa Titans 50 Index. To subscribe to our extensive coverage of the index or other B&M products and services, please contact us at info@bmconsultancy.net or 512-743-6294.

Development

South Africa Announces End of Recession; Interest Rate Remains Unchanged

Countries Affected: South Africa

Companies Affected: ArcelorMittal South Africa, Bidvest Group, FirstRand, Harmony Gold, Remgro, Sanlam, MTN Group, Sasol, Impala Platinum Holdings, AngloGold Ashanti, Standard Bank Group, ABSA Group, Gold Fields, Naspers, and Anglo Platinum.

Sector: Banking & Financial Services, Mining, Oil and Gas, Telecommunications, and Media/Publishing.

Description

The South African government released Tuesday economic statistics showing the country's GDP expanded by 0.9% in Q3 on an annualized basis, boosted by a recovering manufacturing sector (up 7.6%) and a resurgent construction sector (up 6.1%) due to preparation for the World Cup in 2010. Anything above zero indicates the country is no longer in a recession. South Africa followed other global economies into recession in May 2009, the first one since 1992. This marks South Africa's first positive growth in its 9-month-long recession.

Interest Rate The government did not reduce interest rate despite significant political pressure from the African National Congress (ANC), the Congress of South African Trade Unions (COASTU) and the South African Communist Party (SACP). The interest rate currently stands at 7%, which is considered adequate to curb inflation and support economic growth. The ANC wanted a 2% cut in order to weaken the rand.

Inflation is on a downward trend and should further decline toward the South African Reserve Bank's (SARB) target range of between 3-6% for Q2 2010. Inflation has gone from 13% in September 2008 to 6.4% in August 2009 and 6.1% in September 2009.

Rand: The Rand firmed to 7.4875 against the dollar Tuesday soon after the release of the new GDP numbers, up from 7.51 before the release. However, the Rand closed the week on Friday down 2% after news broke that Dubai World, the government investment company burdened by \$59bn liabilities, sought to reschedule its debt, triggering a massive sell-off of high-risk assets. South Africa's highly influential unions seek a weaker currency as well as a reduction in the interest rate, neither of which the government granted.

Consumer Confidence fell earlier in the earlier half of the year. Confidence is still low despite recent positive news about GDP. Consumer spending has been weighed down by South Africa's high unemployment rate (24.5%).

Implications for the Dow Jones Africa Titans 50 Index

Of the 50 companies that constitute the Dow Jones Africa Titans 50 Index, 15 are headquartered in South Africa. Altogether, the 15 DJ Index-listed South African companies account for 28.4% of the index net assets. MTN, Sasol, Impala Platinum Holdings, AngloGold Ashanti, Standard Bank Group, ABSA Group, Gold Fields, Naspers, and Anglo Platinum account for 40% of the DJ Index market capitalization. **Market chatter was largely positive in response to the conclusion of South Africa's recession. However, the Dubai debt crisis, which triggered a massive sell-off of high-risk assets and shares worldwide, ultimately dominated local capital market performance this week.** On Wednesday, the Johannesburg Stock Exchange (JSE) All-Share Index JALSH closed down 0.17% before recovering mildly by .41% on Thursday. However, the JALSH closed for the week on Friday down 1.56%.

Short Term Outlook (Neutral-Positive)

In the short-to-medium-term, hosting the 2010 World Cup should buoy the South African economy through job creation and tourism. Construction has expanded by more than 10% in first half of 2009 and infrastructure spending should continue to boost GDP.

In our Weekly Report for the week ending Friday October 9, we noted South Africa's "manufacturing output contracted by a faster-than-projected 15% in August, suggesting the overall recovery will be slow and politically tenuous. Manufacturing is South Africa's second largest sector after mining. Slides in both sectors have been the biggest burdens on South Africa's sputtering economy, which contracted by 3% in Q2. Several mines have been shut down since the recession began resulting in 30,000 mining jobs lost, thus ranking the ANC's trade union allies. Slow jobless recoveries are a political hard-sell."

In the short-term, we expect the positive GDP news to briefly placate South Africa's highly influential trade unions, especially COSATU, which, along with the SACP and the ANC, form the "Tripartite Alliance," under which the SACP and COSATU promise not to directly contest any elections in exchange for being able to influence ANC policy. However, so long as the recovery remains jobless, this will be short-lived.

Long Term Outlook (Positive/A-)

South African economy should recover more fully in 2010 and will likely lag behind the global recovery by a quarter or two.

Trends to Watch Next Week

Will the good news of South Africa emerging out of recession have any impact on the job creation President Jacob Zuma promised during his election?

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Development

South African Parliament Lowers Interconnection Fees; MTN Staff Reductions

Countries Impacted: South Africa

Companies Affected: MTN

Sector: Telecoms

Description

The South African Parliament lowered interconnection fees as expected this week. This has been a goal of the government regulators for several years but has recently become a bigger priority as a result of the recession and efforts to provide consumers with affordable fees. South Africa's mobile phone charges are the third highest in the world. The South African Communications Ministry announced on November 12, 2009 that mobile operators MTN, Vodacom, and Cell C reached an agreement to cut interconnection rates by 36 cents from R1.25 to 89 cents per minute. The current off-peak interconnect rate of 77cents per minute will remain unchanged for the time being.

The agreement came on the heels of a South African government ultimatum delivered October 16, 2009 to mobile phone companies operating in the country to more than halve interconnection fees. The directive pushed them and the Independent Communications Authority of South Africa (ICASA), which regulates both the telecommunications and broadcasting sectors, to reduce interconnections fees from 1.25 rand to 60 cents by November 30th and by 15 cents each year until 2012.

In light of a decline in its customer base, MTN recently announced plans to significantly reduce its staff to improve operational efficiencies. There is an anticipated cut of 403 permanent employees. The company also plans to cut 70% of 3,000 non-permanent staff and has already closed down 36 non-profitable service stores.

Implications for the Dow Jones Africa Titans 50 Index

MTN is the fifth-largest holding in the DJ Africa Titans 50 Index, constituting 3.61% of its net assets. Of the 15 South African companies represented in the index, MTN is the largest with a market capitalization of \$17.2 billion. It is the only South African telecommunications company listed in the Index. The government ultimatum requiring mobile phone

companies to slash interconnection rates caused MTN stocks to slide as the markets feared reduced interconnection fees could diminish the profitability of MTN and other telecoms companies. On Friday, MTN shares closed at 11,500, down 1.29% from Thursday.

Short-Term Outlook (Neutral-Positive)

In the short-term (i.e. over the next week), we expect the directive on reducing interconnection fees to continue lightly weighing on telecoms and MTN shares due to investor fears that this mandate will reduce short-term profits. This is compounded by the uncertainty surrounding MTN's recent layoffs and reshufflings. The reduction in fees will take effect on March 3, 2010 and for MTN and February 2, 2010 for Vodacom and Cell C.

Long Term Outlook (Positive/B+)

In our Weekly Report for the week ending Friday October 16, we accurately forecasted the threat of the government directive to encourage mobile phone operators to voluntarily reduce their interconnection rates. We also forecasted that, "if done gradually, voluntary reductions could diminish the need for operators to cut expenditure and raise other fees, and, in turn, could boost overall mobile telephony subscription and retention rates and help operators compensate for revenue lost to lowered interconnection fees." We maintain this forecast as the reduction is spread over a two-year period.

Furthermore, MTN is the largest South African telecommunications company. The company should continue to see a rise in subscription as they have successfully established themselves as a leader in the Middle East and Africa with enormous room for growth. Given the termination of negotiations with Bharti-Airtel, expectations are that MTN shares will continue to maintain a gradual upward trajectory. Downside risks would be another reduction in fees mandated by regulators sooner rather than later or that MTN-Bharti talks re-emerge. However, neither of these scenarios is likely before the end of 2009. Nevertheless, the reduction in fees is still targeted to reach .60c/per minute from the new fee of .89c/per minute. This will be achieved by an approximate reduction in .15c through 2012.

Trends to Watch Next Week

How will the reduction in interconnection fees affect MTN stock prices and peers in the telecommunications industry?

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