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The B&M Weekly Africa Markets Report on the Dow Jones Africa Titans 50 Index Week Ending Friday, October 16, 2009

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Development

South African Parliament Calls for Telecoms to Lower Interconnection Fees

Countries Impacted: South Africa

Companies Affected: MTN.

Sector: Telecoms

Description

The South African government delivered Monday an ultimatum to mobile phone companies operating in the country to more than halve interconnection fees, renewing a long-running pursuit that goes back four years but which has recently gained traction since South Africa slid into the first recession in 17 years earlier this year, crimping a working class already struggling with 24% unemployment rates. The Parliament's portfolio committee on communications held hearings with such critical mobile phone operators as MTN and Vodacom during the week. The directive pushes 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.

Naturally, while acknowledging South Africa's mobile phone charges are the third-highest in the world, ICASA and the operators are resisting the government's regulatory overtures, with ICASA suggesting instead that operators limit the mark-up they charge for carrying each other's calls to 50%. On Wednesday, MTN declared its "commitment to engage in a round of voluntary cuts," adding the directive may force it to cut expenditure and raise other fees, criticisms echoed by Vodacom. Critically, the highly influential Congress of South African Trade Unions (COSATU) has spoken in favor of the ultimatum.

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. In response to the news, MTN stocks slid 2.9% from 126.04 rand on Monday to 122.5 rand on Friday as the markets feared reduced interconnection fees could diminish the profitability of MTN and other telecoms companies.

Short Term Outlook (Negative/C-)

In the short-term (i.e. over the next week), we expect the directive on reducing interconnection fees to continue weighing on telecoms and MTN shares, particularly compounded by the uncertainty surrounding an announcement Wednesday by South Africa's Competition Commission that it was investigating possible price collusion between MTN and Vodacom about an agreement to charge each other an interconnection fee of 1.25 rand/minute and 75 cents/minute during peak hours and off-peak hours respectively.

Long Term Outlook (Positive/A)

In the medium-to-long-term, we expect the threat of the directive to encourage mobile phone operators to voluntarily reduce their interconnection rates. 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.

Trends to Watch Next Week

All eyes will be on the Competition Commission's investigation of MTN and Vodacom over their alleged price collusion.

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Development

Central Bank of Nigeria (CBN) Announces Plans to Acquire Shares in Bailed-Out Banks

Countries Affected: Nigeria

Companies Affected: AfriBank, PlatinumHabib Bank, Fidelity Bank, First Bank of Nigeria, Guaranty Trust Bank, Intercontinental Bank, Union Bank Nigeria, United Bank for Africa, and Zenith Bank.

Sector: Banking & Financial Services

Description

The Central Bank of Nigeria (CBN) announced Friday plans to acquire shares in some of the nine recently bailed-out banks if they are unable to recapitalize or find buyers, stressing it preferred them to be bought out by other financial institutions. In the last three months, the CBN has bailed out nine banks to the tune of approximately \$4 billion. CBN pumped \$2.6 billion into AfriBank, First Inland Bank (FinBank), Intercontinental Bank, Union Bank, and Oceanic Bank in August and replaced their CEOs after the first part of the CBN's audit confirmed the banks were so weakly capitalized as to pose a systemic risk. On October 9, the CBN bailed out four more banks (Bank PHB, Equatorial Trust Bank, Spring Bank & Wema Bank) with \$1.4 billion in long-term loans and fired the chief executives of three banks. As at July, banks accounted for about 55% of market capitalization in the Nigerian Stock Exchange (NSE), down from 65% in 2008. **The NSE lifted Tuesday its suspension placed on Spring Bank and Bank PHB shares to prevent a precipitous drop in prices after they were included in the second round of bailouts.**

Implications for the Dow Jones Africa Titans 50 Index

There are 10 Nigerian companies in the DJ Africa Titans 50 Index, constituting 14% of its net assets. Only South Africa has more companies represented in the Index. Nine of these companies are banks (see list above under "Companies Affected"), weighing in at a solid 10.89% of the Index. Four of the nine banks bailed out since August (AfriBank, Bank PHB, Intercontinental, & Union) are currently included in the Index, holding a considerable 2.47% of its net assets. Of the 15 banks that passed the audit, five (Fidelity Bank, First Bank, Guaranty Trust Bank, United Bank for Africa, and Zenith Bank) are represented in the Index, constituting 8.42% of its net assets or 77.3% of the value of the Nigerian banks listed.

The Nigerian Stock Exchange All-Share Index opened Monday up .28% on the government's \$2 billion stimulus package. However, the NSE then went on a four-day skid, precipitated by losses in the shares of bailed-out banks, including Spring Bank and Bank PHB unsuspended on Tuesday. Overall, the NSE recorded losses of 4.47% last week. **Notably, Bank PHB fell about 4.2% from 3.17 on Tuesday to 2.75 on Friday, a relatively mild slide given the circumstances.**

Short-Term Outlook (Positive/A)

After a 2005 CBN-coordinated bank consolidation exercise that resulted in 26 strong banks emerging out of 87 weakly capitalized ones, the Nigerian banking sector strengthened considerably from 2006-2008, with Nigerian banks rapidly expanding across Africa. After riding on ample liquidity caused by record-high crude prices, the Nigerian banking bubble burst last year when crude prices caved. In May 2009, analysts estimated Nigerian banks had up to \$10 billion in toxic assets, the result of at least \$6.5 billion in equity-backed margin loans doled out during the boom years. However, the banks' books did not reflect such liquidity problems, prompting CBN audits. **In the last month, B&M has accurately forecasted CBN would ultimately uncover another \$2-3 billion in non-performing loans and would likely bailout 3-5 more banks.**

In the short-term, CBN's announced plans to acquire shares in some of the nine recently bailed-out banks removes any uncertainties about the banks' survivability and assures there will be a buyer. And the relative durability of the recently unsuspended shares of bailed-out Sprint Bank and Bank PHB underscores the strong faith markets have in the CBN's reform policy.

Nigerian interbank lending rates eased to 4.91% on average Friday from 9.66% the previous week after CBN injected \$1.3 billion into four recently bailed-out banks thus pumping very well-needed liquidity into the system.

We expect the government's recently disbursed \$2 billion stimulus package to buoy liquidity and further ease interbank lending rates. Finally, the Nigerian naira continued its recent strengthening Thursday firming against the U.S. dollar from 152.60 to 151.80 after Chevron announced Thursday plans to sell \$28.4 million to several Nigerian banks. **We expect the relatively well-handled audit to yield short-to-long-term benefits of increased transparency and investor confidence, which should further bolster the naira. So far, the naira's rise has been relatively unaffected by the recent bailouts.**

Long Term Outlook (Positive/A)

B&M maintains (from the last month) its bullish stance on the long-term prospects of Nigerian banks. Despite all the recent turmoil, Nigerian banks (on average) were remarkably still outperforming the FTSE EuroFirst 300, the S&P 500, the Nikkei 225 and the NSE All-Share Index averages. **Once the dust of the bailout clears, B&M predicts another consolidation exercise will ensue from which 16-18 banks will emerge.** The banks that passed the audit (i.e. Access Bank, Diamond Bank, Ecobank Nigeria, Fidelity Bank, First Bank of Nigeria, First City Monument Bank, Guarantee Trust Bank, Savannah Bank, Skye Bank, Stanbic-IBTC Bank, Sterling Bank, United Bank for Africa, and Zenith Bank), will be in pole position to acquire the distressed but still relatively well-capitalized banks, and will become considerably stronger as a result. So far, the heads of bailed-out banks Afribank, Finbank, Intercontinental, and Oceanic have recovered about \$313 million in non-performing loans between them.

Despite CBN's appeals, we forecast a 5% chance that a foreign bank will acquire any of the distressed Nigerian banks. If at all, it will be a South African bank. Regardless, **B&M forecasts a healthier and more transparent Nigerian banking sector will push the NSE All-Share Index across 30,000 points by year's end, tempered, of course, by steadily recovering crude prices.** Of the 15 banks that passed the audit, five (Fidelity, First Bank, Guaranty Trust Bank, United Bank for Africa, and Zenith Bank) are included in the DJ Africa Titans 50 Index.

Trends to Watch Next Week

On Tuesday, Lagos-based *Business Day* reported "between now and February next year, banks will reduce their workforce by between 30 and 40 percent." Will the CBN help the banks avoid the purge?

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