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The B&M Weekly Africa Markets Report on the Dow Jones Africa Titans 50 Index Week Ending Friday, October 2, 2009

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Development

MTN and Bharti Airtel Call Off Merger Plans

Countries Impacted: South Africa

Companies: MTN Group

Sector: Telecommunications

Description

South Africa's MTN and India's Bharti Airtel called off merger plans Wednesday to form the world's third-largest mobile-phone company with annual sales of \$20 billion and 200 million wireless subscribers across more than 20 countries. While the two companies agreed in principle, the deal was ultimately occluded by political chest-beating about which country should maintain ownership of the merged company's assets. The companies were involved in merger talks last year, which failed for similar reasons. This time, the deal-breaker seemed to be South Africa's insistence that India allow Bharti dual list in Johannesburg so its shares can be traded in South Africa. Dual listing, of course, required both countries' currencies to be fully convertible, and the Indian rupee is only partially so.

On Tuesday, India's market regulator changed the country's takeover rules, allowing Bharti to take a 49% stake in MTN in global depository receipts (GDRs), while MTN would have a 36% stake in Bharti, 25 % in GDRs and 11% in equity. Intended to remove the need for dual-listing while placating South African takeover fears, this deal postponed a full merger. **However, the politics of the merger, particularly tenuous on the South African side, proved too much to overcome.** MTN was established in 1994 with considerable government support as South Africa's first black-operated corporate group after apartheid's end. It is the country's second largest and only locally-owned mobile operator.

In the run-up to the September 30 deadline, South Africa's communications regulator announced it might not approve the merger, and the highly influential Congress of South African Trade Unions (COSATU) openly criticized the deal. "It would be sad if we saw this entity move into the hands and management of foreign nationals," said South African Communications Minister Sphiwe Nyanda, hours before the merger collapse was announced Wednesday. "Its management must remain South African." On Thursday, South African Reserve Bank Governor Tito Mboweni said authorities "didn't like" the MTN-Bharti deal, adding "MTN must remain a South African company. It's a very important asset. The chairman, the chief executive officer, the chief operating officer must reside in South Africa."

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. Last week, B&M noted the increasing likelihood of an MTN-Bharti merger failure appeared to buoy MTN shares. Last Wednesday, a day after India's capital markets regulator said it had not received an application for dual listing (seen as the key issue holding up the deal), MTN shares were up 1.2 %, outperforming a 0.07% rise in the JSE Top 40 Index. MTN closed last week on Friday with a 9% rise after news broke South African officials did not approve of India's last minute takeover reforms to facilitate the merger.

MTN opened this week on Monday down 1.2%, its biggest drop in two weeks, as the markets scrambled to make meaning of Indian Finance Minister Pranab Mukherjee's statement Bharti and MTN were not planning the immediate dual listing of their shares. This trend continued on Tuesday, with MTN falling 1%. Meanwhile, the rand appreciated .4% to 7.43 against the dollar in anticipation an MTN-Bharta deal would result in large capital inflows into South Africa and thus help prop up the rand. The rand depreciated 2.5% to 7.61 against the dollar Wednesday when MTN and Bharta called off the merger deal. Fearing dealers might rush to dump MTN shares, the Johannesburg Stock Exchange (JSE) suspended trading of MTN

stocks until Thursday. This move perhaps proved excessive Thursday when MTN shares rallied 5.6%, the largest gain since merger discussions began on May 25. Consequently, Bank of America raised its recommendation on MTN shares from “neutral” to “buy,” and JPMorgan Chase upped its recommendation from “neutral” to “overweight.” On Friday, MTN rallied for a second day, up 2%.

Short Term Outlook (Neutral-Positive)

Last week, B&M forecasted “a 5% chance the merger deal would succeed before the September 30th deadline, due largely to the unyielding political climate in South Africa, where the first recession since 1992 has incited protectionist and xenophobic angst.” **Claims by the South African government that politics played no role in their decision simply do not ring true. The recession has ruptured barely healed intra-ANC divisions Jacob Zuma merely patched up to claim his presidential electoral victory in 2009.** The ANC has a longstanding pact with the South African Communist Party (SACP) and COSATU called 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. The Alliance nearly collapsed during the Thabo Mbeki administration as the SACP and COSATU took aggressive exception to Mr. Mbeki’s more pro-capitalist stance. With his populist campaign rhetoric, Mr. Zuma managed to revive the Alliance, at least until the recession began, further highlighting the little progress South Africa has made in tackling black poverty since the end of apartheid.

Thus, any attempt to weaken the South African identity of one of the country’s few black-controlled groups was and still is politically lethal and unlikely, despite the promise of a merger. Last week, we predicted “Since MTN shares have not suffered as a result of the drawn-out political saga, South African government officials are under little shareholder pressure to rush through the deal, and as such, are not particularly eager to risk putting up a fight against the current preeminent forces at play in South African politics.” As a result, we also accurately forecasted the South African government would “postpone negotiations indefinitely, which will probably have a neutral-positive impact on MTN shares.” MTN and Bharti announced Thursday plans to resolve regulatory issues and restart talks. In the short-term, we forecast MTN shares to continue their mini rally. **Be week end, we forecast renewed MTN-driven vigor in the markets will help push the rand through 7.53/dlr.**

Long Term Outlook (Positive/A+)

In the medium-to-long-term, we expect merger talks to continue, albeit at a slower pace. The promise of a Bharti-MTN merger assures this. However, a deal may not be reached until year’s end, if at all. And, if it does, the terms will certainly be in MTN’s favor as South Africa will firmly have the upper hand in shaping a new merger deal. MTN and Bharti announced Thursday plans to resolve regulatory issues and restart talks. However, regardless of the outcome of future MTN-Bharti merger talks, we are bullish on MTN’s medium-to-long term prospects. In March, coming on the heels of rapid growth and expansion the previous year, MTN CEO Phuthuma Nhleko said the company would make a “meaningful” acquisition in 2009 as part of MTN’s plan to expand beyond Africa. In light of the merger flop, we expect this ambition to manifest itself in MTN expanding within Africa and further bolstering its position as the continent’s largest wireless operator. In April, MTN crossed the 100-million customer mark, largely as a result of adding new users in Nigeria. Despite its continental dominance, MTN is still only present in 16 African countries. With its vast resources, established networks and partnerships across Africa, MTN’s Africa growth potential is promising.

Trends to Watch Next Week

MTN and Bharti announced Thursday plans to resolve regulatory issues and restart talks. It remains to be seen how soon they intend to do so.

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Development

Central Bank of Nigeria (CBN) Bails Out Four More 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

On Friday, the Central Bank of Nigeria (CBN) bailed out four more banks with \$1.4 billion in long-term loans and fired the chief executives of three banks. Concluding its second and last audit of 14 banks, CBN found Bank PHB, Equatorial Trust Bank (ETB), Spring Bank and Wema Bank “to be in a grave situation.” CBN ruled Unity Bank to be insufficiently capitalized but not in a “grave situation.” It also fired and replaced the executives of Bank PHB, Spring Bank and Equatorial Trust Bank, while sparing Wema Bank’s chief executive as he had only been on the job since June. Unity Bank and Wema Bank have until June 30, 2010 to recapitalize or face stiffer sanctions.

This new bailout brings the total CBN liquidity injection into the banking system to approximately \$4 billion in the last two months. 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. Last Monday, Nigeria’s *Business Day* reported Nigerian law enforcement agents had seized travel documents belonging to the chief executives of the four newly bailed out banks, suggesting more CBN bailouts and bank executive removals were imminent. Notably, CBN announced last Monday the second audit results would be released in two weeks, adding “the clear indications are that the bulk of the problems have been effectively dealt with in the first round.” As at July, banks accounted for about 55% of market capitalization in the NSE, down from 65% in 2008.

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.

Last week, despite news suggesting more CBN bailouts and bank executive removals were imminent, Nigeria’s bank-dominated Nigerian Stock Exchange (NSE) All-Share Index continued its mini banking stock-induced rally from the previous week when CBN Governor Lamido Sanusi assured shareholders of the 14 banks still being audited there would be no more shocks in the CBN’s audit. Markets sobered mildly last Friday falling by .8% with investors selling off banking stocks to lock in profits from previous gains. That trend continued Monday with the NSE sliding by 0.63%, and on Tuesday as the NSE fell .99%. Notably, the DJ Index-listed Spring, Diamond, Guaranty Trust and First banks were all down on Tuesday. After three consecutive days of losses, the NSE rebounded .43% on Wednesday buoyed by banking stocks. Two previously bailed-out banks (AfriBank & Oceanic) and two still being audited at the time (Zenith & Wema) all rose. Remarkably, Wema Bank, which would ultimately be included in the second bailout, was up 4.31% on Thursday, a day before being sanctioned. Markets were largely unaffected by the new bailouts as CBN released the audit results after the stock markets had closed on Friday.

Short-to-Medium Term Outlook (Negative-Neutral)

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 suspicions. The first round of CBN’s audit uncovered about \$4 billion in toxic assets, which was far off the estimates.

In the last two weeks, B&M accurately forecasted CBN would ultimately uncover another \$2-3 billion in non-performing loans and would likely bailout 3-5 more banks. We accurately predicted, despite the imminence of more CBN bank bailouts and executive firings, Nigerian banking shares would continue their mini rally in the short-term, which they have so far. Lastly, we forecast, as we have in the last two weeks, that Nigerian banking stocks would fall in the days immediately after CBN released its second audit report. Markets were largely unaffected by the new bailouts as the CBN released the audit results after the stock market had closed on Friday and earlier than expected. Nigerian interbank lending rates eased to 9.66% on average Friday from 11.33% last week after Abuja disbursed windfall oil savings to government agencies thus pumping very well-needed liquidity into the system. In the short term, we expect the disbursement of more bailout money to buoy liquidity and further ease interbank lending rates. Finally, the Nigerian naira continued its recent strengthening Friday firming against the U.S. dollar from 149.51 to 147.32 after demand for the dollar weakened. 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 has been unaffected by news of the new

bailouts.

Long Term Outlook (Positive/A+)

B&M maintains (from the last two weeks) 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. And this is despite the Nigerian banking stocks being at their lowest value since before the 2005 consolidation exercise. Once the dust of the second bailout clears, B&M predicts another consolidation exercise will ensue from which 16-18 banks will emerge. The banks that pass 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 slowly 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

We expect CBN to maintain its commitment to protecting depositors and assisting distressed banks in their loan recovery efforts. If decisive and swift enough, these efforts should help shorten the expected slide in banking stocks.

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