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POLITICAL RISK CONSULTANTS

## The B&M Weekly Africa Markets Report on the Dow Jones Africa Titans 50 Index Week Ending Friday, September 18, 2009

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<b>Development</b> MEND Ends and Then Extends Ceasefire
<b>Countries Impacted:</b> Nigeria <b>Companies:</b> Tullow Oil, Sasol & Acergy S.A. <b>Sector:</b> Oil & Gas
<b>Description</b> <b>Crude oil markets braced for the worst Monday when Nigerian oil militants Movement for the Emancipation of the Niger Delta (MEND) announced they would end their 60-day cease-fire on Tuesday to resume their activities with “the utmost zeal.”</b> MEND’s activities are primarily to blame for the 20% reduction in Nigeria’s oil exports since 2006. The 2-month lull in their activities combined with President Yar’Adua’s 60-day weapons-for-peace amnesty program since July have helped Nigeria increase its oil production to 1.7 million barrels a day from 1.2 million earlier. But MEND announced Wednesday it would extend its ceasefire by 30 days, allowing time for more negotiations. However, MEND has vowed not to participate in the current amnesty program, which ends October 1, and the Nigerian government has not shown any willingness to cede to the group’s more ambitious demands.
<b>Implications for the Dow Jones Africa Titans 50 Index</b> <b>The three oil &amp; gas companies in the Dow Jones Africa Titans 50 Index (Tullow Oil, Sasol and Acergy S.A.) constitute a weighty 11.06 percent of its net assets.</b> Sasol and Acergy S.A. are particularly invested in Nigeria. Acergy’s “conventional business” focuses entirely on West Africa, including its 40-year-old Globestar fabrication yard in Warri, Nigeria. Acergy recently signed a \$190 million offshore platform revamping contract with Exxon-Mobil. Sasol is a joint-owner, along with Chevron and the Nigerian National Petroleum Company (NNPC), of the \$6 billion Niger Delta-located Escravos gas-to-liquid (GTL) project, which has been delayed on multiple occasions due to militant attacks, prompting Sasol to recently reduce its economic interest in the project from 37.5% to 10%. <b>The lull in militancy has been a boon for oil and gas companies operating in the Niger Delta, including Sasol and Acergy.</b> Any return to violence will certainly drive down the value of their stocks, notably for Sasol, which was cut to “neutral” from “buy” at UBS AG on Tuesday. Between Monday and Thursday, Sasol shares fell by 2.43% from 308 rand to 300.5, compounded by sliding global crude prices and Sasol’s announcement Monday that it expects FY 2009 profits to fall partly due to its failure to comply with black ownership laws.
<b>Short Term Outlook (Neutral/B)</b> On Wednesday, oil prices broke above \$72, but this was due primarily to a U.S. government report showing a bigger-than-expected decline in crude inventories. The MEND announcements will continue to have a neutral effect on global crude oil prices.
<b>Long Term Outlook (Negative/C-)</b> B&M projects MEND will resume its activities at the conclusion of this new 30-day cease-fire. There is nothing in the ongoing negotiations between MEND and the Nigerian government that suggest otherwise. In fact, B&M forecasts that MEND will be more forceful upon its return as it attempts to fill the notable void created by militant leaders who have accepted the government’s amnesty disarmament program.
<b>Trends to Watch Next Week</b>

After meeting with and convincing two top Niger Delta militant commanders Ateke Tom and Government Ekpemupolo to accept the amnesty, Nigerian Defense Minister and former Niger Delta governor Godwin Abbe has been lauded for his diplomacy skills. So far, MEND, the most powerful of the militant groups, has shunned Abbe's advances. We expect them to maintain this stance.

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## Development

Nigerian Central Bank Reassures Shareholders on Bank Bailout Plans

**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 Wednesday, Central Bank of Nigeria (CBN) governor Lamido Sanusi assured shareholders the five banks bailed out in August would be treated fairly and that there would be no more shocks in the ongoing banking sector audit.** The CBN's previous declaration that the five bailed out banks would be operated as "going concerns" until new investors recapitalized them sparked shareholder fears that the banks' value would be weakened. Sanusi also said results of an audit of Nigeria's 14 other banks would be released on-schedule early October. The 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 a CBN audit confirmed the banks were so weakly capitalized as to pose a systemic risk. As at July, banks accounted for about 55% of market capitalization in the Nigerian Stock Exchange (NSE) All-Share Index, 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, weighing in at a solid 10.89% of the Index. Three of the five banks bailed out in August (AfriBank, Intercontinental Bank and Union Bank) are currently included in the Index, holding a considerable 2.12% of its net assets. After Sanusi's announcement, Nigeria's bank-dominated NSE All-Share Index soared 1.27% to 21,542 points Thursday, rising for the second day in a row. Notably, FinBank gained 2.08%, the first time since August 17<sup>th</sup> that any of the five rescued banks gained. The share price of the other distressed banks (Oceanic Bank, AfriBank and Intercontinental Bank) fell Thursday, but at a slower pace. The NSE's banking stock rally also came on the heels of a full endorsement Tuesday by the International Monetary Fund (IMF) of the CBN's bailout plan.

## Short-to-Medium Term Outlook (Negative/C-)

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. So far, the CBN's audit has uncovered about \$4 billion in toxic assets, which is far off the estimates. **B&M forecasts CBN will uncover another \$2-3 billion in non-performing loans and will likely bailout 3-5 more banks. We forecast Nigerian banking shares to continue their mini rally for the next few days but will nosedive in the days before and immediately after CBN releases its second audit report in early October.**

## Long Term Outlook (Positive/A+)

**B&M remains bullish on the long-term prospects of Nigerian banks.** Despite all the recent turmoil, as at August 15, 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 bailout clears, B&M predicts another consolidation exercise will ensue from which 16-18 banks will emerge. The banks that pass the audit (so far, Access Bank, Ecobank Nigeria, First Bank of

Nigeria, Diamond Bank, United Bank for Africa, Guarantee Trust Bank and Skye Bank), will be in pole position to acquire the distressed but still relatively well-capitalized banks, and will become considerably stronger as a result.

On Thursday, the heads of distressed banks Afribank, Finbank, Intercontinental Bank, and Oceanic Bank announced about \$313 million in non-performing loans had been recovered 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 banks that have passed the audit thus far, three (First Bank, Guarantee Trust Bank and United Bank for Africa) are included in the DJ Africa Titans 50 Index.

#### **Trends to Watch Next Week**

On Tuesday, FirstRand Ltd., South Africa's second-biggest financial-services company, said it was considering expanding into Nigeria. It remains unclear whether FirstRand has made a formal inquiry on any of the distressed Nigerian banks.

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#### **Development:**

The DRC Cancels First Quantum's Kolwezi Mining Contract

**Countries Affected:** The Democratic Republic of the Congo (Congo-Kinshasa)

**Companies:** First Quantum Minerals Ltd.

**Sector:** Mining

#### **Description**

**The Democratic Republic of the Congo (Congo-Kinshasa) confirmed Monday its decision to cancel First Quantum Minerals Ltd.'s contract for the highly lucrative Kolwezi copper project, saying the company was reluctant to renegotiate its contract as stipulated under the government's ongoing review process of 61 mining contracts.** First Quantum owns 65% of the \$553 million project, which was set to launch in 2010 and eventually produce 70,000 tons of copper. First Quantum announced Wednesday it declared force majeure and froze construction on the Kolwezi project, prompting a precipitous drop in the company's share price.

#### **Implications for the Dow Jones Africa Titans 50 Index**

**First Quantum Ltd. is the 17<sup>th</sup> largest holding in the Dow Jones Africa Titans 50 Index, constituting 2.42% of its net assets.** The company forecasted total copper production of 406,000 for 2010. So the Kolwezi mines contract cancellation represents a sizable 17% FY2010 production loss and considerable sunk costs.

#### **Short Term Outlook (Negative/C-)**

On Wednesday, First Quantum's shares predictably plunged by 9%, before rebounding a bit and settling at C\$70.35. In the short-term (the next few days), B&M forecasts continued volatility in the share price as company officials scramble to manage the fallout of the ruling.

#### **Long Term Outlook (Positive/A+)**

First Quantum's decision to declare force majeure on the Kolwezi mine project initially precipitated the sharp slide in its share price. However, we believe this swift and decisive action will ultimately calm investors and return the company's share price to pre-expropriation levels.

#### **Trends to Watch Next Week**

It is unclear if and the extent to which the Kolwezi ruling will affect First Quantum's only other investment in Congo-Kinshasa, the \$226 million Frontier Copper project. Launched in 2007, Frontier produced 80,177 tons of copper in 2008, 24% of the company's total output. First Quantum's 14% increase in production by Q3 2009 is partly attributable to higher than expected output at Frontier.

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