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The B&M Weekly Africa Markets Report on the Dow Jones Africa Titans 50 Index Week Ending Friday, September 25, 2009

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Development

South African Government Sends High Officials to India to Discuss MTN-Bharti Airtel Merger

Countries Impacted: South Africa

Companies: MTN Group

Sector: Telecommunications

Description

The South African government dispatched a team of high-powered officials to India Monday to revive the troubled proposed merger between South Africa's MTN Group and India's Bharti Airtel, facing an increasingly infeasible September 30th deadline for agreement. Under discussion since May 25, the merger would form the third-largest mobile-phone company in the world with annual sales of \$20 billion and 200 million wireless subscribers across more than 20 countries. While the two companies have agreed in principle, the deal has been 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 appears 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, means both countries' currencies must be fully convertible, and the Indian rupee is only partially so. **The politics of the merger are particularly tenuous on the South African side.** MTN was established in 1994 with considerable government support as South Africa's first black-owned corporate group after apartheid's end. It is the country's second largest and only locally-owned mobile operator. South Africa's communications regulator announced the week before it might not approve the merger, and the highly influential Congress of South African Trade Unions (COSATU) has criticized the deal.

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. The week before the meeting, the market positions of MTN and Bharti yo-yoed as a result of the drawn-out jostling and uncertainty surrounding the deal. Last week opened on Monday with MTN dropping for the second day losing 2%. However, the stock rallied a bit towards the end of the week closing Thursday up 1.85%, outperforming the JSE Top 40 Index.

Overall, while the current structure of the deal is still very much shrouded in secrecy, the increasing likelihood of failure appears to be benefiting MTN. On Wednesday, after India's capital markets regulator said the day before 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 this week with a 9% rise after India's *Economic Times* reported the visiting South African officials told their counterparts that India's latest change in takeover rules to facilitate the deal would make it difficult for the merger to be completed. Comparatively, Bharti shares have been down the whole week.

Short Term Outlook (Neutral-Positive)

B&M forecasts a 5% chance the merger deal in its current form will 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. More importantly, 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 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-owned groups is politically lethal and unlikely, despite the promise of the merger. 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. The South African delegation to India is expected to release its report next week. We predict the government will postpone negotiations indefinitely, which will probably have a neutral-positive impact on MTN shares.

Long Term Outlook (Positive/A+)

On Tuesday, India’s market regulator changed the country’s takeover rules, allowing Bharti to take a 49% stake in MTN in global depositary 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 postpones a full merger. However, the deal is still shrouded in too many uncertainties to drive sufficient shareholder and government confidence in it. In the medium-to-long-run (beyond the September 30th deadline), 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 likely be in MTN’s favor as South Africa will firmly have the upper hand if negotiations extend beyond September 30th.

Trends to Watch Next Week

The South African delegation to India is expected to release its findings and recommendations sometime next week. We predict the government will postpone negotiations indefinitely.

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Development

More Nigerian Banks to be Bailed Out?

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

Nigeria’s *Business Day* reported Monday that, over the weekend, Nigerian law enforcement agents seized travel documents belonging to the chief executives of four out of the 14 Nigerian banks currently undergoing a Central Bank of Nigeria (CBN) banking sector audit. The banks allegedly affected were Bank PHB, Wema Bank, Spring Bank and Equatorial Trust Bank (ETB). *Business Day* also reported Nigerian law enforcement sent alerts to all airports and border stations ordering that the 14 banks’ executives and debtors be barred from traveling out of the country. Many Nigerian analysts interpret this series of events to be a harbinger of more CBN bailouts and bank executive removals. 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.

Last week, CBN Governor Lamido Sanusi sent the bank-dominated Nigerian Stock Exchange (NSE) All-Share Index on a mini banking stock-induced rally when he assured shareholders of the 14 banks still being audited there would be no more shocks in the CBN’s audit. Sanusi also said results of the ongoing audit would be released on-schedule in early October. *Business Day*’s article seemed contradictory to a CBN announcement Monday confirming 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. Three of the five banks bailed out in August (AfriBank, Intercontinental & Union) are currently included in the Index, holding a considerable 2.12% of its net assets. Of the 14 banks still being audited, three (Bank PHB, Fidelity & Zenith) are represented in the Index, constituting 2.66 of its net assets. Of the four banks implicated in the alleged heightened monitoring by Nigerian law enforcement, Bank PHB is listed on the DJ Africa Titans 50 Index.

In response, upon its reopening Wednesday after Muslim holidays, the NSE soared 1.7% to 22,236 points, precipitated by hefty trading in banking stocks. Notably, bailed-out Union Bank was one of four banks whose stocks constituted 54% of volume traded. Stanbic-IBTC, one of the banks still being audited, gained 5%. NSE rose for a fifth straight day Thursday, up 1.2% on a continued banking stock rally. Two bailed-out banks (Oceanic & Intercontinental) and one still being audited (Zenith) all rose. By contrast, one bailed-out bank (FinBank) and two still being audited (Spring & Fidelity) slid. Markets sobered mildly Friday falling by .8%. However, bailed-out banks (Intercontinental & Union) both gained, rounding up a relatively solid week for Nigerian banks listed in the DJ Africa Titans 50 Index.

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.

So far, the CBN’s audit has uncovered about \$4 billion in toxic assets, which is far off the estimates. **Last week, B&M forecasted CBN will ultimately uncover another \$2-3 billion in non-performing loans and will likely bailout 3-5 more banks. This forecast is consistent with the *Business Day* report suggesting more bailouts are imminent. We maintain this forecast.** We also forecasted last week that, despite this looming possibility, Nigerian banking shares would continue their mini rally in the short-term, which they have so far. We forecast, as we did last week, that this rally will continue in the short-term 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 maintains (from last week) its bullish stance 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.

Last Thursday, the heads of bailed-out banks Afribank, Finbank, Intercontinental, and Oceanic 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

Business Day reported Friday the next round of executive replacements “will be through the various boards of the banks, so as to provide soft landing for the embattled chief executives.” If true, this plan could also shorten the depreciation in banking stocks in the run-up to and after CBN releases the results of its ongoing audit.

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