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BEE investment deals may fall victim to global recession

December 02, 2008 *Edition 2*

South Africa's drive to give black investors stakes in white-run blue-chips may fall victim to the global financial crisis, forcing a major rethink of a core policy that is meant to redress the economic ills of apartheid.

Under black economic empowerment (BEE), which has stirred controversy but is now broadly accepted by corporate South Africa, firms in Africa's biggest economy must meet quotas on black ownership, employment and procurement.

That means bringing black investors on board and giving them an equity stake usually via complex deals funded by the company, banks and existing shareholders through the issue of new shares.

Black investors usually repay the loans with dividends and sometimes cashflow, and the shares themselves act as collateral.

In a bull market, the newly rich black investors see their assets grow and comfortably use healthy dividends and cashflow to meet monthly payments, even using stock to back more loans.

But South Africa's Top 40 index of blue-chip stocks has plunged almost 30% this year and falling commodity prices have hit cashflow in the key mining sector. BEE deals seal-ed at the height of the market are now looking increasingly vulnerable.

"There is no doubt that the current economic crisis will have a material impact on BEE transactions done in the last few years," said Ajay Lalu, director of Bravura Economic Empowerment Consulting firm, which advises companies on BEE.

Industrial group Imperial and Eqstra, which it spun off in May, have been the first big firms to see their BEE deal fall prey to sliding markets.

Imperial and Eqstra stock prices have slipped closer to a trigger or share cover ratio level built in to the deal, and they said this month they had to pump in an extra R100 million (\$10.08m) in cash to shore up BEE partner Lereko.

Imperial, Africa's biggest transport and logistics firm, said if it hadn't injected cash the deal would have collapsed and funders would have taken control of Lereko's board.

Imperial and Eqstra would also have lost their empowerment credentials which are crucial for doing any business with the government.

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Other companies that inked stock-backed deals between late 2005, when the Top-40 last plumbed current depths, and the market peak in May, might also have to restructure or pump in more cash.

Petrochemicals firm Sasol sealed the biggest BEE deal yet in March with a transaction worth some \$3.2bn at the time, issuing shares at R366 each.

The stock dropped to R287.32 by Friday's close and certain share cover ratios will be breached if the 10-day volume weight average falls below R211, forcing Sasol to buy back shares issued to the banks to rescue the deal.

Barloworld repriced its planned BEE deal in August given plunging asset prices - a move that ruffled some shareholder feathers at the time but in hindsight looks astute.

In the mining sector, black investors face a double whammy of falling asset prices and battered commodity prices.

Black-owned junior miner Anooraq has delayed a deal with Anglo Platinum as it struggles to raise funds in current market conditions.

The initial price tag was \$445 million but is being renegotiated given a slide in platinum prices.

"In our view, this is nothing less than a failed business enterprise," said Royal Bank of Canada's mining analysts in a research note on BEE in the gold and platinum mining sector.

"So what does the government then do in order to deliver on the promise of BEE, or does BEE slowly become yesterday's dream?"

BEE has long faced criticism for simply shifting wealth into the hands of a few powerful black businessmen - many of whom have strong links to the ruling ANC.

BEE deals worth R96bn rand were agreed in 2007, 19% of total mergers and acquisitions (M&A), according to Ernst & Young. - Reuters

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