

VODACOM GROUP

Empowerment in reverse?

Inappropriately structured deal 'robs' disadvantaged beneficiaries



PETER MOYO Shareholders get full benefit

A CAREFUL READING of the 2009 annual report of recently listed cellphone operator Vodacom Group shows its previously disadvantaged shareholders in its South African unit might be paying to empower the rest of the group's international operations without any due benefit to them.

That's a direct result of the structuring of Vodacom's black economic empowerment deal last year, which restricted the empowerment partners' participation to 6,25% of Vodacom SA. Some might argue the structure relegated the empowerment participants to second-rate investors, much like in the past. Those include the Royal Bafokeng Holdings (RBH: 2%) and Thebe Investment Corporation (2%), together with retail black South Africans who subscribed for shares. They're effectively sitting at a different level to other shareholders.

In financial 2009, as has always been the case, Vodacom SA generated the entire group profit of R6,2bn. Vodacom went ahead and used the money to fund its international operations without giving consideration to the minorities who stand to benefit nothing from its international growth. The SA unit is a fairly mature investment with no significant growth prospects – hence the need to look outside.

Last year the group spent R6,9bn on capital expenditure, with 37% of that going to Vodacom International (the five African countries in which it operates) and the acquisition of Gateway (an Egyptian-based satellite and terrestrial network infrastructure company). This financial year it's budgeted R8bn for capital expenditure: R3bn (37%) for international operations. That despite the fact Vodacom International only brought in a R600m operating profit while Vodacom SA generated 86% of the R55bn group revenue and R12,7bn operating profit.

There's no funding mechanism between the two divisions (the SA unit and International) that proportionally compensates Vodacom SA's minority shareholders for their subsidisation of its working capital and capex in the bigger group.

The question therefore has to be asked: What justification could there be for those previously disadvantaged South Africans to subsidise the likes of Vodafone Group, Vodacom's controlling shareholder? Surely empowerment is about empowering SA's previously disadvantaged, not the reverse? Had Vodacom's empowerment deal been structured at group level, all shareholders would have been in the same boat.

Vodacom chose to evade *Finweek's* written questions about the matter, but after a three-day delay, Vodacom SA MD Shameel Joosub said: "To the extent that Vodacom Group's international operations require funding, this is either raised externally or provided for by Vodacom Group." That was after he had said Vodacom SA does "not pay dividends" to the international operations.

Our question sought to clarify the fairness of the current funding mechanism on Vodacom SA's minorities. "These dividends are paid to Vodacom SA shareholders, those being Vodacom Group (93,75%) and its empowerment shareholders."

There's no argument about that. The issue is that whatever is left for working capital and capital investment goes to subsidising the international operations, at the expense of the minorities in Vodacom SA.

"The empowerment shareholders are being robbed of their rightful participation in Vodacom if that's in fact the case," says Ajay Lalu, CE of Bravura Consulting. Lalu was among the chief architects of the broad-based black economic empowerment Codes of Good Practice on which the

Vodacom deal was based.

Lalu says there must be a commercial funding agreement between Vodacom SA and the group covering the "big risks" faced by the empowerment shareholders. "Or the current funding model for group capital requirements should have ceased after the empowerment deal was done, as Vodacom now has minority shareholders."

Lalu is surprised by the fact Vodacom SA's empowerment partners – Thebe and the RBH – haven't raised the issue, as both are sophisticated and with the necessary resources in terms of skills. "They have a real problem here. They also have access to strong corporate finance teams that should be able to identify those issues and respond accordingly," says Lалу, himself a chartered accountant.

Lalu added: "Imagine what's happening to other, less sophisticated empowerment groups – especially broad-based groups, such as community trusts and employee share schemes – if RBH and Thebe aren't responding to issues like this."

Asked if that was a manifestation of the codes' shortcomings about the structuring of empowerment deals – where a company is regarded as fully empowered even when it restricts empowerment participation to local assets – Lалу says empowerment beneficiaries have at some stage to look after their own interests. "They can't rely completely on legislation."

Vodacom might get away with the situation, as the historical nature of funding empowerment deals is such that beneficiaries are relegated to a junior partnership because they're heavily reliant on the goodwill of the majority owner for participation. Similarly, Thebe and the RBH can't exactly be expected to vigorously tackle Vodacom on the issue.

Thebe's representative on the Vodacom SA board – Vusi Khanyile – says it's "not proper for a shareholder to speak out of turn on internal matters. The issues are being discussed in the company – inside the walls of the company. Engagement is happening among the shareholders."

Khanyile would neither confirm nor deny the issue of aligning shareholders' interests had been raised at board level, except to say Thebe is of the view the status

quo is "not the end destination. Where you start isn't necessarily where you end." Khanyile's insistence on "internal matters" also doesn't help those minorities who don't have access to the board.

RBH CE Niall Carroll voiced a similar sentiment. "It's a fair question. I'm sure that's something the Vodacom board would consider, in order to ensure the alignment of Vodacom SA shareholders' interests with the rest of the group." Again, Carroll was non-committal when asked if the issue had ever been raised with the board.

As already stated, it's not completely surprising that Thebe and RBH aren't speaking out on the issue.

A source close to the process raises another disturbing fact: the amount of executive time spent on its international operations relative to Vodacom's SA unit. "My concern is that the executive spends all its time looking for growth opportunities at the detriment of the SA operation. We (Vodacom SA shareholders) pay for that time."

The source says he understands the possibility of "flipping up" the SA minorities to group level has been raised with Vodafone, the controlling shareholder.

Vodacom Group chairman Peter Moyo says the issue of "flipping up" the empowerment shareholders to group level is "not something we have spoken about for now" at group board meetings. He added it wouldn't be out of the realm of possibility were it to arise.

Moyo was also quick to point out he doesn't believe Vodacom SA's minorities are unfairly compromised in the current environment. "They get the full benefit of their shareholding," says Moyo. He says Vodacom still spends a "significant chunk" of its capital expenditure on the SA unit. "We look at growing the cake for all shareholders – and the SA shareholders aren't excluded," says Moyo. "If we were to migrate the SA shareholders to group, we'd need to do the same for local shareholders in the other countries."

Vodafone's representative on the Vodacom board refused to talk to *Finweek* about this matter.

In all the countries in which it operates Vodacom has local partners as shareholders.

Migration of all those shareholder groups to Vodacom Group level isn't only desirable for the alignment of shareholders' interests it would bring about. It would also achieve the real empowerment objective in SA: to empower the previously disadvantaged.

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AJAY LALU Black empowerment shareholders robbed blind