M&A declined this year, but it's not all bad news

Merger & acquisition (M&A) transactions in South Africa declined in terms of both the volume and value of domestic and cross-border deals in the first half of this year. Transactions fell by 44% and 52% in terms of volume and value respectively, in the first half of 2018 compared to H1 2017. Last year, there were 243 total deals worth $6,625m in South Africa, this decreased to 135 deals worth $3,207m in H1 2018.

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“There are a number of elements causing the M&A market contraction in South Africa, says Morne van der Merwe, managing partner and head of the corporate/M&A practice at Baker McKenzie. “Firstly, this decrease in M&A activity shows that we should not underestimate the impact of corruption and suboptimal governance in South Africa on the mood of investors.”

State capture and corruption

Van der Merwe explains that the issues around state capture and bribery and corruption have made international investors cautious.

“It has proved all too easy for business to get caught up in these issues. There are various examples of multinationals in South Africa and further afield in Africa who have become embroiled in corrupted environments and there are serious consequences attached to this. In the United States and the United Kingdom, for example, the anti-bribery and corruption laws carry with them significant penalties for non-compliance.

“Investor reluctance is not just about government corruption, however,”Van der Merwe explains. “The Steinhoff narrative has put South Africa in the spotlight and raised concerns about governance in the private sector as well.”

Investors holding back

“Further, economic concerns, the threat of another credit rating downgrade, issues around service delivery, as well as the fact that South Africa is close to its next election means that investors are also holding back, adopting a wait-and-see approach. There are also two major political issues causing uncertainty and affecting investment confidence and appetite, land reform and national health insurance.

“Within certain sectors there are issues as well. For example, mining sector M&A in South Africa has died down considerably due to regulatory uncertainty.”

Some recent interesting developments include the announcement that the struggling state owned enterprise South Africa Airways will look at partial privatisation.

“If this is a hint at changing government policy on the issue of privatisation, this could stimulate investment and be positive news for the M&A market, depending on how successful government will be in managing stakeholder engagement ” Van der Merwe says.

Inbound

In terms of sectors attracting M&A investment, the report shows that Industrials garnered the highest number of cross-border inbound deals into South Africa during the period (22% share). It was also the top performing sector based on aggregate value, representing 91% of the total. There were eight inbound transactions in the Industrials sector in South Africa in the first half of 2018, worth $362m.

“There are a lot of opportunities available in the industrials sector in South Africa, because it is so well established and has managed to stay the course in a challenging environment. Inbound investments in the industrials sector are also a good entry point into African economies as this sector is a focus area for many developing economies across the continent,” he says.

Van der Merwe notes that a potential challenge facing Africa is the rapid international development of a new economy based on artificial intelligence, sophisticated systems and markets.

“We should be making sure that South Africa and other countries in Africa are not left behind. We need to encourage innovation, technological advancement and skills development and implement laws to protect innovators and users.”
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According to the report, Mauritius engaged in the most number of transactions (eight altogether) in South Africa, while Singapore invested the most during the first six months of the year. The high value of investment from Singapore was due to the fact that the top inbound deal in H1 2018 was the merger of the Singaporean and South African business units of Grindrod Shipping Holdings, valued at $320m.

“Mauritius is coming on to the radar as an investment hub in Africa, mostly because of the beneficial tax regime they have introduced. Mauritius has made it much easier for companies and service providers servicing investment holding companies to set up in Mauritius and structure investments into Africa,” van der Merwe explains.

Outbound

Outbound deals in South Africa were mostly split between the materials, industrials, consumer products & services and high

technology (cutting edge technology) sectors, each representing an 11% share to deal volume. Each of these sectors completed five outbound deals in the first half of the year. However, in terms of aggregate value, Financials was the most popular, accounting for almost half of the aggregate value - $1,050m – in the first half of 2018.

In terms of outbound deal destinations, South African companies mostly engaged in deals with the UK (ten transactions making up 23% of the total deal volume). Morocco had the highest aggregate deal value, accounting for 48% of the total. This was thanks to Sanlam Ltd's buyout of Moroccan company Saham Finances SA for $1.1bn.

"The ease of doing business with the UK, brought about by various factors, including, language, time zones, easy access, historical ties and familiarity, has meant that investment between the two countries has always been good. Brexit has impacted positively on investment between the UK and South Africa in that it has caused UK trade outreach initiatives to various of its historic trade partners, including South Africa," van der Merwe adds.