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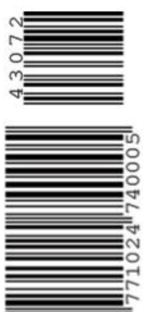

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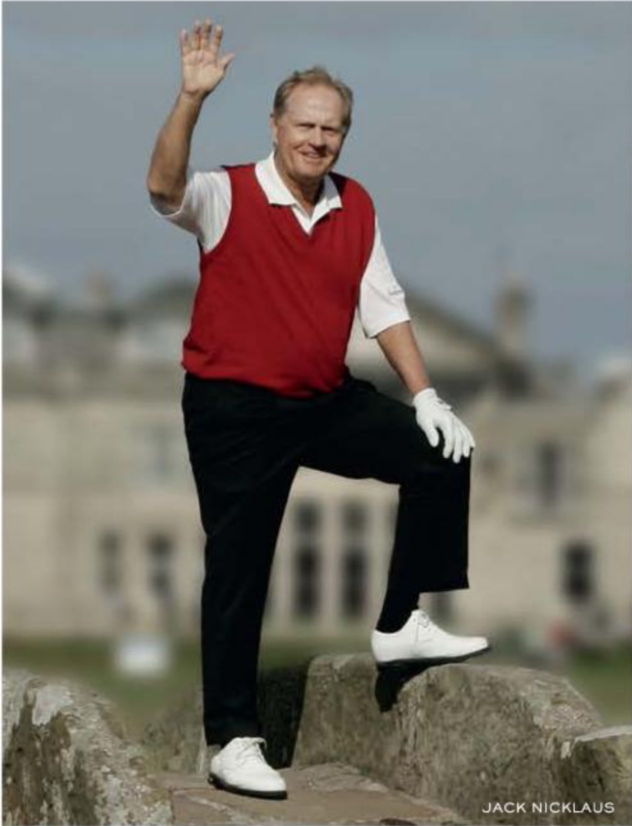
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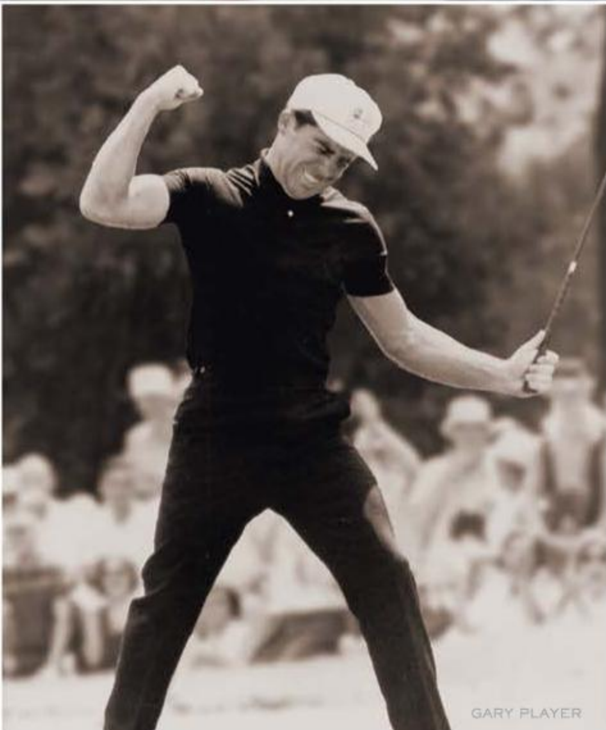

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IN PLATINUM

from the editor

JANA MARAIS

A recent trip to the US, to visit Sasol's $11bn Lake Charles Chemicals Project which is currently under construction, served as a good reminder that South Africa is small fry in the big scheme of things. Even Sasol's own investment in the US (which is six times as large as the net foreign direct investment of $1.8bn into the entire South African economy last year) is dwarfed by the scale of investments taking place in the petrochemical sector along the Gulf of Mexico in Texas and neighbouring Louisiana. (Also see p.36)

Buoyed by cheap shale gas, chemical companies have been piling into the Gulf area, with nine new ethane crackers expected to start production by 2022. It's difficult to make an exact comparison, but imagine several Secundas sitting side by side all the way from Pretoria to the Vaal Triangle. Nationwide, the American Chemistry Council has counted 264 planned projects – of which nearly half is already completed or underway – totalling an investment of $164bn.

Louisiana offers a number of lessons for SA. The low price of natural gas and natural gas liquids, which are used as feedstock in chemical plants, is a key reason why the US has been on the radar of chemical companies, but it's by no means the only part of the world with cheap gas on offer. Sasol has a long record of gas production in Mozambique, for example, and already uses cheap gas in Qatar to produce fuel.

The clincher for Sasol, and many of its multinational rivals, is the investment-friendly environment in the US. Louisiana makes it easy to do business there by providing certainty and clarity when it comes to environmental legislation (think in contrast about the long-running proposals around new air quality legislation and a carbon tax in SA, for example), and provides some lucrative financial incentives. The cost and availability of supporting infrastructure, such as railroads and ports, also serve to sweeten the deal in a massive way. And unlike in SA and the Middle East, there are also no requirements to hand over a chunk of the project to a government or other partner.

Admittedly we're not exactly comparing apples with apples – the US is a rich, developed country, and SA's history makes requirements such as empowerment shareholdings a non-negotiable necessity in order to build a sustainable, fairer society. But the reality is this: capital is mobile and unsympathetic, and we'll need to up our game if we want to play in the big leagues. ■

Jana Marais travelled to Lake Charles as a guest of Sasol.

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By Peter Fabricius

CYBER WARFARE

Putin: Puppet master behind the scenes?

Some observers believe Hillary Clinton is being targeted by Vladimir Putin's regime in order to give Donald Trump an advantage in the US presidential race. Some Western governments also believe Russia is trying to discredit them.

Is Russian president Vladimir Putin trying to get Donald Trump elected as the next president of the US by rigging the November 8 elections? That sounds extremely far-fetched and conspiratorial, but US intelligence agencies really believe it's so, according to a range of mainstream US media.

The agencies say Russian intelligence is behind two outfits called Fancy Bear and Cozy Bear, which have hacked mainly into sites belonging to the US Democratic Party and the campaign of its presidential candidate, Hillary Clinton.

The recent leaking of her campaign manager's emails and Clinton's speeches to Wall Street bankers has embarrassed her and damaged her campaign by revealing awkward inconsistencies in her approach to such critical issues as government regulation of the US financial industry and free trade.

Though Trump's campaign seems to be tanking now, the possibility of even more damaging revelations from Clinton's confidential communications remains a wild card in this election.

Electoral authorities in a large number of US states have also reported intrusions into their computer systems.

Adding credibility to all these claims is that these intrusions fit into a pattern already familiar to countries in Russia's backyard, especially Ukraine, Poland and the three Baltic states, Estonia, Latvia and Lithuania.

They will tell you that Russia has been conducting cyber warfare against them for years. Even Sweden, a historically neutral country, is on high alert regarding Russia. This includes the resurrection of its civil, psychological and economic defence operations, which were last active during the Cold War.

Gallo/Getty Images

Is he trying to get Trump elected? Or is he just trying to disrupt the elections, to discredit the American electoral system and therefore its cherished democracy?

Mikael Tofvesson, who heads the Swedish Civil Contingencies Agency (MSB in Swedish), which is responsible for these operations, says its tasks now include identifying and countering disinformation from Russia designed to disrupt the country and undermine trust in the Swedish government and in Nato. The body also counters cyber attacks that could crash Sweden's increasingly digitalised infrastructure controls.

Niklas Granholm of the Swedish Defence Research Agency in Stockholm sees the Russian cyber attacks as part of a campaign of "hybrid warfare" which Russia is conducting against the West, and particularly Nato. That campaign also includes efforts to influence the politics of Western countries by providing financial and other support to far-right nationalist parties like France's Front National and the Swedish Resistance Movement.

These parties share with Putin a love of strong, authoritarian government and a dislike of anything "alien", including immigrants, the EU and Nato.

That sounds a lot like Trump's agenda. He has already declared on the campaign trail his admiration for Putin and his reluctance to come to the rescue of fellow Nato members if they are attacked – which terrified the tiny Baltic states in particular. He has also proposed that Japan and South Korea should arm themselves with nukes against North Korea, so that they would no longer have to depend on the US to defend them.

And, most pleasingly to Putin's ears, he has said he would pull the US out of Syria and leave Russia, Iran and Syrian president Bashar al-Assad to crush the Syrian dissidents without hindrance.

In contrast to Trump's isolationist policy, Clinton would maintain America's strong support for Nato and would probably maintain, if not increase, its military support for the democrats fighting Assad.

Even so, US intelligence seems undecided about Putin's motives in "spearphishing" the US elections. Is he trying to get Trump elected? Or is he just trying to disrupt the elections, to discredit the American electoral system and therefore its cherished democracy? US officials believe it is impossible to rig the elections electronically, because they are conducted at state level and the various state-side computer systems are not connected to the internet.

So some intelligence analysts believe Putin just wants to create confusion and doubt about the election results, which might provoke Trump to call foul and reject the outcome if he loses, as he has already threatened to do, even hinting at a violent reaction.

The Obama administration has been left rather flat-footed by this cyber war. It is apparently reluctant to retaliate in kind because it fears – like Sweden – that Russia could launch a massive cyber counter-strike, knocking out its transport and other infrastructural controls. As he is doing in Ukraine and Syria, Putin seems to be out-manoeuvring the US by exploiting its reluctance to escalate confrontation.

And what about South Africa? To the dismay of its Western partners, Pretoria has remained conspicuously silent about Russian aggression in places like Crimea, eastern Ukraine and Syria. That's in part because of their joint membership of the Brics bloc, which seems to be the real cornerstone of South Africa's foreign policy.

Undoubtedly too, the ANC quietly welcomes Putin's aggression as a counterweight to what it sees as the untrammelled exercise and abuse of power by the US. And President Jacob Zuma, like Trump, is fond of Putin. But SA is playing a high-stakes game, especially if the Russia-Nato conflict grows.

And oddly, the ANC, traditionally closer to the US Democrats, now finds itself in the same bed not only as Vladimir "Cozy Bear" Putin but also Donald "Wild Dog" Trump. This relationship would get a little too close for comfort if Trump was to win on 8 November. ■

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Peter Fabricius was foreign editor of the Independent Newspaper group for 20 years, writing on African and global issues. He has been writing weekly columns for the Institute for Security Studies (ISS) since 2013.

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the week

in brief

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>> **IN THE NEWS:** Leery investors adopt wait-and-see aproach over Brexit *p.12*
>> Analysts turn upbeat on gem miner *p.14*
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>> How big is SA's black middle class really? *p.16*
>> What can we expect from Gordhan's upcoming mini budget? *p.18*

"A $50, $60 OIL PRICE – ABSENT A SUPPLY ACCIDENT – IS SUFFICIENT TO DEVELOP THE LOW-COST RESOURCES TO PROVIDE INCREASES [IN SUPPLY] THAT WILL BE NECESSARY OVER THE NEXT THREE TO FOUR YEARS."

Saudi Arabian Oil Co.'s refinery facilities in Ulsan, South Korea.

– **Andrew Gould, board director at state-owned Saudi Arabian Oil Co.,** said at an oil conference in London on 18 October that Saudi Arabia, the world's biggest oil exporter, doesn't expect prices to rally much further before the end of the decade, Bloomberg reported. (Also see page 36.)

"If you look at the number of malls versus the number of people with disposable income, it doesn't make sense. There has to be a sorting out."

– **Edcon CEO Bernie Brookes** says he subscribes to the idea that South Africa is over-malled and can see evidence in the cannabalisation between his own stores. Edgars in Mall of Africa drew 75% of its volumes from four surrounding stores in Centurion, Midrand, Fourways and Sandton, Brookes says. Edcon plans to close 10% of its 1 500 stores over the next three years as their leases expire. (Also see page 39.)

"STOP WHINING."

– **US president Barack Obama** said in a press conference on 18 October that he'd advise Republican presidential hopeful Donald Trump, who has complained that the elections on 8 November will be rigged in favour of his Democratic opponent Hillary Clinton, to rather try and make his case to get votes. Obama said Trump's assertions of vote-rigging were "based on no facts", bbc.com reported.

Getty Images/SeongJoon Cho/Bloomberg

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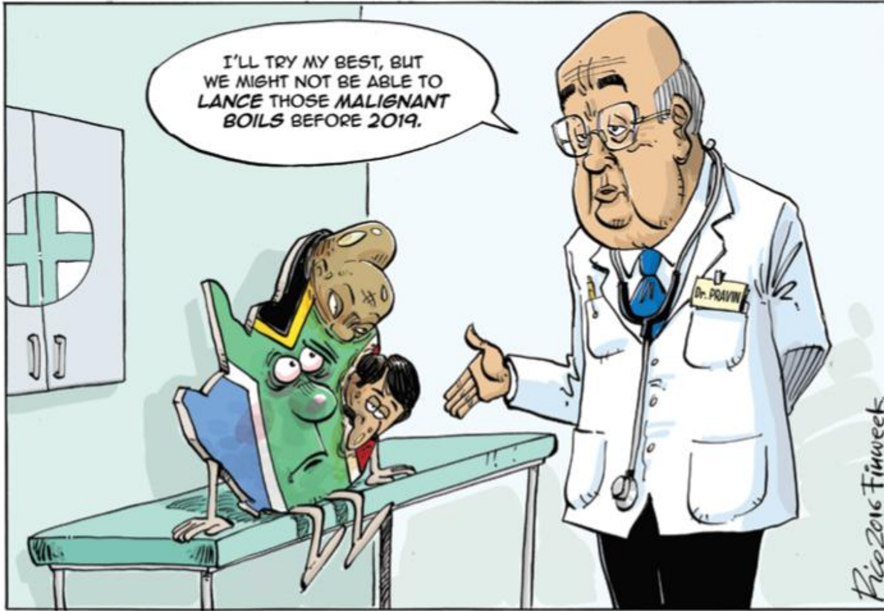
DOUBLE TAKE BY RICO



THE GOOD

Following pressure from Parliament, the Public Investment Corporation (PIC), the biggest shareholder on the JSE, has made its portfolio of unlisted investments public for the first time. The PIC's unlisted portfolio totalled R44.6bn at the end of March, a fraction of its overall asset base of R1.8tr. By disclosing its interests in, and the performance of its unlisted portfolio (which includes Independent Media), the PIC, whose biggest client is the Government Employees Pension Fund, can quell concerns that it bows to political pressure to invest in specific ventures.

THE BAD

About a year after Parliament's energy committee requested an independent forensic report from the department of energy into PetroSA's failed Project Ikhwezi, which led to an impairment of a whopping R14.5bn in the 2014/15 financial year, the state-owned enterprise is yet to deliver the goods, *Business Day* reported. It submitted a summary of the report to the committee on 18 October, leading committee chairperson Fikile Majola to request the full report in November and bring minister Tina Joemat-Pettersson along to do some explaining.

THE UGLY

Foreign investors have been net sellers of local equities to the tune of R102.2bn in the year to 14 October, JSE data shows. About R64bn of this is related to SABMiller and AB InBev, according to *Business Day*. It also shows that South Africa is currently unattractive as an investment destination, while local indexes are fairly expensive, Denker Capital's Kokkie Kooyman told the paper. Foreigners have been net buyers of local bonds to the tune of R57.6bn over the same period, mainly thanks to low yields in developed markets.

DIS-CHEM PLANS JSE LISTING

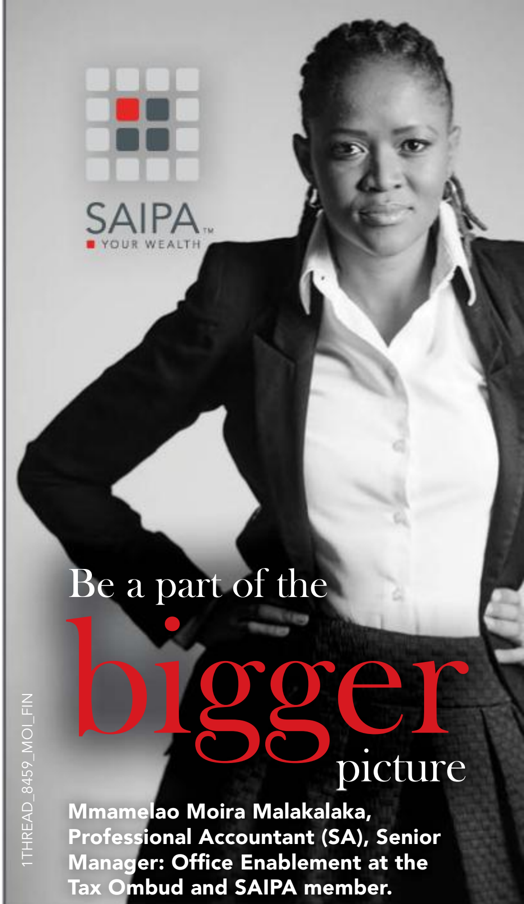
R25bn

Pharmacy group Dis-Chem, which was founded in 1978, is planning to list on the JSE's main board to raise capital in order to double its store footprint in the next five to eight years, from its current 101 stores in SA and two partner stores in Namibia, Moneyweb reported. Details about the listing date and size of the capital raising were not yet available at the time of going to press. The group is expected to list with a market capitalisation of R25bn, Moneyweb said. CEO Ivan Saltzman's family trust currently owns 66.9% of the business, with the balance held by management and a financial investor, Moneyweb said.

CHINESE GROWTH ON TARGET

6.7%

The Chinese economy grew at an annual rate of 6.7% in the third quarter, in line with the government's full-year target, ft.com reported. However, there are concerns that this year's better-than-expected growth in China has been the "byproduct of a dangerous expansion in credit, especially for real estate developments and state-backed infrastructure projects", ft.com said. More than 20 urban governments across China have recently introduced measures to contain house prices, which have increased by as much as 25% in cities such as Beijing and Shanghai over the past year, it reported.



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YOUR WEALTH

By Glenneis Kriel

Health coaching by phone

The development of new technologies is making it possible to provide deep, impactful and caring connections between healthcare professionals and patients suffering from diabetes, regardless of location.

Diabetes has been identified as one of South Africa's biggest non-communicable disease threats. According to the International Diabetes Federation, the disease caused 67 318 deaths and affected more than 3m people in the country, at a cost of about $900 (R13 500) per person in 2015. With only 2.286m cases having been diagnosed, thousands of people are unaware that they are ill.

The number of people diagnosed with diabetes is predicted to increase to well beyond 5m by 2040, due to complex reasons, including genetic factors, and changes in food consumption patterns combined with increasingly sedentary lifestyles that have come with urbanisation.

Richard Johnson and Graham Rowe, the co-founders of Guidepost, saw this trend as an opportunity to add value to medical health services.

"When we started the company four years ago, we initially wanted to offer medical treatment based on genetic sequencing. We however soon realised that much of the basics of healthcare are deeply flawed in their real-world implementation," says Johnson.

He explained that the outcomes for diabetes in SA were pretty abysmal, in spite of great treatment protocols and excellent drugs: "Diabetes results in a lot of avoidable suffering, including complications like amputation, blindness and strokes. The problem is that only about half the people with diagnosed cases receive care and only about half of those produce positive outcomes. We therefore started a company that uses technology to enhance these outcomes."

The approach has resulted in a 40% reduction in hospitalisations and complications.

Graham Rowe and **Richard Johnson** are the co-founders of Guidepost.

The challenges

Access to care is one of the big challenges with diabetes. "Hospitals and clinics are often too overburdened or inaccessible to provide patients with the necessary support and assistance," explains Johnson. "To improve your health when you have diabetes requires serious lifestyle changes, relating to your diet, dosage and timing of medication, exercise and much more. You won't be able to make these lifestyle changes in a one-off visit to your GP."

He says Guidepost, which was a finalist in this year's FNB Business Innovation Awards, is not trying to replace general practitioners (GPs), but rather trying to become an aid with which GPs could produce better disease outcomes.

The development of new technologies and the move to on-demand marketplace services, such as Airbnb and Uber, have created an environment where people can receive care whenever and wherever they want it. Guidepost is going with this flow by gathering information from clients, analysing the profiles of clients and then linking them up with suitable nurses for tele-coaching, "since outcomes have been found to be greater when you receive coaching in your own language from someone with whom you can relate".

The service entails unlimited diabetes coaching sessions as well as coach reports and personal guidance. It also helps to reduce travel costs and time wastage for patients.

"Guidepost in effect is like having a personal trainer; you don't get better in one session, but have someone to support you, show you new techniques, explain things and walk the path with you over a number of coaching sessions," Johnson explains.

Access to data is an obstacle to positive outcomes on the nursing side. Johnson explains that nurses have a lot of knowledge and skill, but are often unable to make informed decisions because of the way in which data was organised. "It is much more difficult to make informed decisions when you keep data with a pen and paper in an old file, than if you use new technology to process the data into usable information, say for example of a patient's blood glucose levels."

"The development of big data and artificial intelligence is helping the industry to produce data-driven insights that move healthcare away form pure intuition into the realm of analytics and data-driven decision-making," says Johnson. "Our business is absolutely obsessed with data and analytics. All of the coaching we provide and the algorithms we have created use biometric data to drive decision-making, augmenting the intuition of the experienced diabetes coach. The approach has resulted in a 40% reduction in hospitalisations and complications."

The future

Since it was founded four years ago, the company has developed a network of partner coaches throughout the country with over 30 full-time employees. It has performed more than 50 000 consultations helping over 5 000 people with diabetes improve their health. Clients are referred via doctors or they sign up directly via the Guidepost website. The company also has pharmaceutical clients, who include this service with their treatment, as they recognise the importance of having patients taking their drugs correctly.

Guidepost has taken a very systematic approach from the start, to ease future expansions. Johnson says the company's main goal is to facilitate long healthy lives. "About 80% of people with diabetes also suffer from other co-morbidities, such as high blood pressure or high cholesterol. The company is therefore developing systems to also address these problems. It has already branched out to other management services for people with chronic kidney disease, transplants and some cancers," he explains. ■

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Image: Guidepost

“What’s the key to completing this international acquisition?”

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By Glenda Williams

Brexit: Will uncertainty take its toll on the United Kingdom?

Persistent uncertainty is likely to see wary property investors waiting for the dust to settle.

With the UK economy – post-Brexit – likely to be considerably restructured in the coming years, it is unsurprising that wary property investors are waiting for more clarity on the effects of the UK's decision to leave the EU before dipping their hands in their wallets.

That search for clarity drew large audiences to the Brexit-themed sessions this year at Expo Real, an annual international trade fair for real estate and investment held in Munich early in October.

"For the moment, things are holding up pretty well," said Mahdi Mokrane, head of research and strategy for Europe LaSalle Investment Management, in London, speaking at one of the sessions. "Next year this time we will see if things have unravelled or not because at some point, uncertainty will take its toll on the UK."

Expectations are that the UK is heading for a "hard" (clean break) Brexit, outside the single market, focusing on sovereignty and restrictions on immigration, with a possible bespoke relationship in some regions.

The fundamentals in the UK are mixed. The country has a twin deficit problem, a budget and current account deficit. According to Brexiteer and UK economist Gerard Lyons, the Bank of England is focusing on the commercial property sector. But there are other areas of the economy that look to be slowing down, so fundamentals, policy and retaining confidence will be key issues.

Lyons though sees Brexit as a fantastic opportunity for the UK. "Monetary and fiscal policy are likely to be very stimulative so as a result growth is likely to remain steady over the next couple of years."

The Bank of England's stance of significantly easing monetary policy that included an interest rate cut of 0.25% is expected to add £5bn in spending to the economy over the next year.

Even the pound's 31-year low against the dollar, reached early in October, has put what Lyons terms the "overvalued" pre-Brexit currency at an attractive level.

Not all were as upbeat about Brexit.

"The case for a collaboration between cities and businesses in Europe has never been stronger. We have to redouble our efforts to remain outward facing," says Sir Howard Bernstein, chief executive of Manchester City Council.

From left: **Gerard Lyons,** UK economist; **Sir Howard Bernstein,** chief executive of Manchester City Council; **Mahdi Mokrane,** head of research and strategy for Europe LaSalle Investment Management; **Wenzel Hoberg,** Triuva CEO, and moderator, **Judith Evans,** property correspondent, *Financial Times*.

In central London LaSalle manages about 200 000m^2 of office space. Its main concerns are the occupier and the sustainability of income and rental dynamics, especially in light of corporate occupiers requiring (post-Brexit) flexibility on lease-breaking options. While the company has only had one leasing deal swept off the table as a direct result of Brexit, Mokrane says they are mindful that this could change rapidly. Uncertainty and complexity are not aided by further potential bumps.

> "Buying at discounted exchange rates in an uncertain environment gives the buyer more power in the deal-making."

Notwithstanding the effects of uncertainty on currency markets and interest rates, further challenges may arise from expensive hedging deterring investors, a potential legal challenge to Article 50, fears of Scotland seeking independence and the string of elections in Europe, French and German elections due in mid-2017.

It is also not impossible that the process of exiting the EU started by the UK could spread to other countries.

But with uncertainty comes opportunity as Triuva, Germany's largest investment management company for institutional real estate investors, can attest to, having purchased two buildings post-Brexit – one in London and another in Edinburgh.

"Buying at discounted exchange rates in an uncertain environment gives the buyer more power in the deal-making. But we also lost some deals because of the uncertain environment," adds Wenzel Hoberg, Triuva CEO.

While discounted exchange rates, better deals and the possibility of additional company tax breaks are seen as an opportunity for investors, many countries and investors around the globe are waiting for the dust to settle.

But not all. Bernstein says there is still strong interest from Asia in the Manchester area helped in part by that continent's long-term view and penchant for rule of law.

London though remains the focus for global investors and even given all the uncertainty, Lyons is confident that the city will remain the financial centre of Europe.

Article 50 will be invoked by end March 2017 at the latest. A two-year process, that means an EU exit by spring of 2019. Although no deals can be done before the UK's exit has been finalised, Britain, says Lyons, has already began trade negotiation talks with a number of non-EU countries.

For investors, it could be a long, uncertain wait. "I believe the uncertainty will ripple out and things will settle in two to three years," says Hoberg. ■

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Glenda Williams was a guest of Messe München South Africa at Expo Real.

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By David McKay

Taking advantage of early gem move

Pallinghurst Resources suffered a beating during the commodity downturn, but now analysts are turning upbeat.

Pallinghurst Resources CEO Arné Frandsen warned investors in August that it was perhaps too early to call the recovery of the commodity markets. He may have had specific reasons for the caution. Pallinghurst was a bit beaten up in the downturn, posting non-cash losses of $33m in its 2016 financial year, most of which related to Gemfields, a UK-listed firm in which it has a 47.59% stake.

Analysts, however, are turning upbeat on the stock – a view that seems to be reflected from about mid-July. Shares in Gemfields fell 26% during its 2016 financial year but then traded up to a 12-month high in early October.

The stock has since weakened a tad but Macquarie believes there's a lot of value in the company largely owing to its first-mover advantage.

Gemfields is the creation of mining veteran Brian Gilbertson, who recognised about 10 years ago that there was an opportunity to establish a dominant player in coloured gemstone mining.

At the time, the industry consisted of small companies and there was almost no concerted marketing effort. Having seen tanzanite briefly challenge diamonds, might then the same be achieved for emeralds, rubies and sapphires?

Starting with the Kagem emerald mine in Zambia, followed by the Montepuez ruby mine in Mozambique, Gemfields set about its masterplan of establishing a big-hitter presence in the market. Gilbertson then bought Fabergé from Unilever (where it was being used to market aftershave and deoderant) in an effort to give amorphous gemstones a name and a brand.

"To this extent we see Gemfields more as an integrated luxury goods play but with most of the current value in the upstream mining business," said SP Angel, a UK stockbroker that initiated coverage of Gemfields earlier this year.

Global imports of emeralds, rubies and sapphires reached an estimated $5.9bn in 2015, a 13% improvement year-on-year and which is thought to be stronger than diamond demand.

Now Gemfields is expanding its mines. In the next three years it hopes to produce 40m carats of emeralds and 20m carats of rubies a year.

Said Macquarie: "Gemfields has a strong first-mover advantage in the emerging gemstone market. It achieved a ten-fold increase in emerald pricing over the past five years by delivering a consistent and reliable supply in the market, and believes 5% to 10% annual real price growth is achievable for the medium term. ■

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Brian Gilbertson
Chair of Pallinghurst Resources

From January to June De Beers sold about

30%

more diamonds than it produced.

Arné Frandsen
CEO of Pallinghurst Resources

The outlook for diamonds

De Beers sold $485m worth of diamonds in its eighth sight, where it meets with pre-approved buyers of its rough or unpolished diamonds. This was lower than the previous sight of $639m but far, far higher than the $200m sold this time last year.

The view among analysts is that the diamond market is showing signs of recovery, which is extremely good news for Anglo American, the 85% owner of De Beers, as well as Petra Diamonds, a UK-listed company that operates mostly outside of South Africa.

For instance, from January to June De Beers sold about 30% more diamonds than it produced, which has the effect of eating into inventories that had been built in the downturn of 2015.

Macquarie warns that diamond sales tend to taper as the year draws to its conclusion, while new diamond production is coming on stream following the commissioning of De Beers' Canadian operation Gahcho Kué among others. All in all, global production is expected to increase to 150m carats by 2018 from 127m carats in 2015.

But fundamentally, it looks good for diamonds. "In the short term of between three to six months we think there's potential for a dip in prices, before a stabilising period," said Macquarie. "But thereafter we think a period of price growth of between 5% to 10% a year during 2017 to 2019 is likely," it added. ■

By David McKay

Water licence a sea change for Keaton

The long wait for an integrated water usage licence for its Moabsvelden coal project cost Keaton Energy a lot of money.

Mandi Glad, CEO of JSE-listed coal junior Keaton Energy, described the awarding of an integrated water use licence (IWUL) by the department of mineral resources for its Moabsvelden coal project in Mpumalanga as a "game-changer" for the company.

The licence has been in the works for more than a year, which led to delays so profound that Gunvor, the Swiss-headquartered trading house that had bought future supplies of coal from Moabsvelden, asked for its money back.

As a result, Keaton wrote down some $4m in impairments, of which a hefty slice was for the 600 000 tons of coal that should have been supplied to Gunvor. The money will have to be repaid, but the fact that Moabsvelden now has a clear run to development changes things.

Glad told *finweek* Gunvor and other trading houses could help finance the $20m to $30m required to build the mine, in return for a new offtake agreement. Whether this affects the money Keaton is committed to paying back remains to be seen.

The development of another stream of revenue is a positive development for Keaton. That's because Moabsvelden borders on Keaton's Vanggatfontein mine, its only operating colliery at present, and therefore building the mine is more like a brownfield extension than a new project.

Capital costs will be lower owing to shared infrastructure and operational expenses. There's also some spare capacity at Vanggatfontein washing plant at present, which means that even before Moabsvelden is completed it will be able to generate some revenue.

"Changes to our balance sheet owing to Moabsvelden will be material," said Glad. "Moabsvelden will produce about 80% of Vanggatfontein's cash. It will be a game-changer." The Vanggatfontein-Moabsvelden complex will produce a total of four million tons of coal a year (mtpa) of which 2.4mtpa to 2.5mpta is from Vanggatfontein and the balance from Moabsvelden.

Keaton suffered close to a R300m loss in its financial year ended 31 March, largely owing to the impairments, so the extra cash from Moabsvelden will be more than handy. There's also been an improvement in the thermal coal market after China cut its working week for its collieries.

"I've heard the long-term thermal coal price called at about $70/t. The fact that it's even gone past there is quite amazing," said Glad. "Let's hope it's not just a blip." The thermal coal price is currently trading at $84/t, an improvement of some 20% over the past month and 56.8% for the year to date.

"We got as far as we could with Eskom before waiting on the IWUL. To start by going back to Eskom; well, it's not a good time for Eskom at the moment, is it?"

Interestingly, Glad said Keaton would seek to sell its coal from Moabsvelden to industrial users outside of South Africa rather than to Eskom, which was the original destination for its product.

"Given the situation with Eskom we have started to look at other options," said Glad. Delmas coal can't ever be washed to export quality, but there is a market in India for coal for industrial users. We are talking about selling to India via a trading house," said Glad.

"We got as far as we could with Eskom before waiting on the IWUL. To start by going back to Eskom; well, it's not a good time for Eskom at the moment, is it?" said Glad.

Eskom has been caught up in the wider political intrigue in South Africa culminating in the decision by two asset management firms, including SA's Futuregrowth, to pull their investments in the utility owing to fears about its corporate governance standards. The Treasury is also running an investigation into Eskom's coal procurement activities, especially regarding coal companies owned by the Gupta family, which has close ties with President Jacob Zuma. ■

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Reasons for the rand's volatility revealed

Increased commodity price volatility and US economic surprises were identified as the two main drivers of rand volatility, according to a working paper by the International Monetary Fund. "When it comes to economic data surprises, only US surprises matter for rand volatility," the authors explained in their report titled *Surprise, surprise*. "South African surprises, including inflation surprises, do not enter as significant explanatory variables." While South Africa cannot control commodity price volatility or global financial market volatility, it could strengthen its buffers, they said, with specific reference to political uncertainty.

19/10/2016 07:56

UK out of top five investment sites post Brexit

The UK dropped out of businesses' top five locations for investments for the first time in seven years as fears about the country's plans to exit the EU added complexity to international deals, EY said in its *Global Capital Confidence Barometer* report. British businesses now rank behind investments in the US, China, Germany, Canada and France. EY surveyed more than 17 000 executives in 45 countries between August and September. Business leaders are concerned about geopolitical issues, such as the rise of nationalist governments worldwide and currency fluctuations that make cross-border mergers and acquisitions more difficult, EY said.

17/10/2016 15:45

Travelling with a Note 7? You could face a R2.5m fine

Samsung has set up exchange booths for the controversial Note 7 devices in airports around the world, ahead of massive fines being imposed by aviation authorities. The US Federal Aviation Administration issued an Emergency Restriction/Prohibition Order on the Note 7, stating that it was a federal offence to be found in possession of the device on board any flight, with penalties of up to $179 933 (R2.5m) for those failing to comply. The South African Civil Aviation Authority also recommended that airlines and other operators ensure that passengers and crew do not carry the device on board.

18/10/2016 17:02

By Sibonelo Radebe

Time to mind the gap

The movement for a wealth tax in South Africa is gaining momentum with the release of a new study that contradicts popular claims that the black middle class has grown significantly since 1994.

Conducted by a Stellenbosch University scholar, Anna Orthofer, the study brings new insight into the field of studying inequality in South Africa and finds that the wealth gap is much wider than previous assumptions. Titled *Wealth inequality in South Africa: Evidence from tax data*, the study declares that about 95% of total South African assets are held by only 10% of the population. And that this 10% remains predominantly white.

In a piece published in The Conversation Africa, Orthofer says SA's concentration of assets at the top is extraordinarily pronounced. "This share (of top wealth holders) is much higher than in the advanced economies, where the richest 10% own 'only' around 50% to 75% of all assets." (A distinction should be made between wealth and income inequality: Orthefor found "robust evidence" in her study that wealth is much more unequally distributed than incomes: while 10% of the population holds about 95% of the wealth, they earn 55% to 60% of all labour incomes. The study was based on more than 1.2m personal tax records for the 2011/12 tax year and a survey conducted among almost 36 000 South Africans in 2010/11.)

The study decimates popular theories that have claimed that SA has achieved significant wealth redistribution since transforming its politics into a democracy 21 years ago. Such theories come from different ends of the political spectrum. For instance, the "white right" tends to overstate the pace of economic transformation in what looks like a trick to hide sustained historical privileges.

Black wealth

This tendency is reflected in the insistence by the JSE that black people control about 23% of the value of the Top 100 companies listed on the Johannesburg bourse. Despite serious questions about the research, which shows black ownership at the end of 2013, entities like the Free Market Foundation and trade union Solidarity have held on to this claim in order to advance an argument that black economic empowerment policies are no longer necessary.

This tendency is reflected in the insistence by the JSE that black people control about

23%

of the value of the Top 100 companies listed on the Johannesburg bourse.

BEE analyst Duma Gqubule, co-founder of KIO Advisory Services, noted that "the JSE's statistics have become a political tool used by fringe groups on the right to support an anti-transformation agenda."

The ruling party has a schizophrenic posture on this matter. When it suits them, mainly when they seek to assuage the black masses, ANC leaders condemn the slow pace of BEE and call for the need for radical economic transformation.

But then the ANC also knows the view that economic transformation has not really taken off earnestly reflects badly on its 22-year ruling tenure. And so from time to time the ANC issues glowing interpretations of economic transformation in order to demonstrate that it is living up to the expectations of its support base.

The view that SA has seen significant economic transformation is destroyed by Orthofer. She declares that past interpretations of SA's inequality were mainly distorted by over-reliance on income and consumption-focused tools of analysis.

One such analysis is the study by the UCT Unilever Institute of Strategic Marketing, *Black Diamond: SA's Emerging Black Middle Class*, which was published in 2006 and used consumption patterns to paint a glowing picture of the state of the emerging black middle class. And that theory is generally supported by income-based studies that have spoken of a growing black middle class. As such the country's middle class is generally thought to account for about 40% of the population.

Orthofer observes: "The next 40% of the population – the group that is often considered to be the middle class – earn about 30% to 35% of all income, but only own 5% to 10% of all wealth." She adds that "the poorest 50% of the population, who still earn about 10% of all income, own no measurable wealth at all."

This translates into a remarkable conclusion that the so-called South African middle class is largely without assets.

"My analysis suggests that a 'propertied middle class' is largely non-existent. This differentiates SA from the advanced economies, where a much larger share of the population owns significant financial and non-financial wealth."

Tax reform

The findings of Orthofer's study come as SA is considering a major tax reform under the umbrella of the Davis Tax Committee. A number of considerations are on the table. Speaking to the wealth gap, the Davis Tax Committee seems to be more focused on closing gaps in the existing estate duty system.

Orthofer says the Davis Tax Committee's early thoughts around adjusting the estate duty system are a step in the right direction. But she points out that addressing wealth inequality needs a holistic approach that, while seeking to redistribute some of the existing wealth, must also focus on building wealth from below.

This speaks to the need to foster the culture of savings and investment in SA. This has been a sore point for a while, with no solution in sight.

SA runs with a savings rate of about 15% of its GDP, which is extremely low when compared to other

Anna Orthofer
Stellenbosch University scholar

"The JSE's statistics have become a political tool used by fringe groups on the right to support an anti-transformation agenda."

Duma Gqubule
BEE analyst and co-founder of KIO Advisory Services

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Images: Supplied

"The level and distribution of wealth in a country are important indicators of its citizens' long-term welfare."

countries. For example, China maintains a savings rate of about 50%, India 30%, Brazil 25% and Australia 22%. This affects the country's capital formation level, which is a key factor of stimulating economic development. Simply put, a low domestic savings rate robs the country of affordable capital to grow economic activity.

Orthofer says government also needs to look at broader economic policy initiatives that will help prompt middle-class households to create wealth. These may include a monetary policy that promotes savings and investment, tax incentives and most importantly through an agreeable retirement fund regime.

The South African government seems to have developed a bigger appetite for a more comprehensive wealth tax. In addition to the mandates it has given to the Davis Committee, the pro-wealth-tax voices of government have become bolder in recent years.

The ANC came out of its 2015 National General Council with a policy position to consider feasibility and applicability of a wealth tax.

The wealth tax movement was boosted by the visit to SA of Professor Thomas Piketty last year. Presenting the 13th Nelson Mandela Annual Lecture, Piketty said South Africa can do with "a progressive annual tax on net individual wealth, even if it comes with a very low tax rate to begin with".

Piketty added that "the big advantage of an annual tax on wealth is that it would produce democratic transparency about wealth and we would know more about who owns what in South Africa and how this is changing over time".

For her part Orthofer noted that introducing the wealth focus as opposed to income-based analysis into the study on inequality is critical for a number of reasons. She said "the level and distribution of wealth in a country are important indicators of its citizens' long-term welfare".

She adds that "wealth is also of particular concern for long-term inequality. This is because wealth can generate its own income (such as interest, dividends, rents, and capital gains), and can be passed on between generations. Over time, small differences in assets can therefore grow larger and larger." ■

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Sibonelo Radebe is business and economy editor at The Conversation Africa.

French economist Thomas Piketty at a press conference before he gave the 13th Nelson Mandela Annual Lecture in October 2015.

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By Mariam Isa

Dancing on the edge of disaster

Finance minister Pravin Gordhan's medium-term budget on 26 October will come under intense scrutiny for evidence that the Treasury's solid track record of sticking to strict spending and debt targets will hold up in the face of perceived attempts to erode the integrity of the country's most respected institutions.

Few doubt that Gordhan – who has stood firm against blatant attempts by political opponents to undermine his authority and force him to step down – will depart from the fiscal discipline that over the past two decades has enabled South Africa to win global financial credibility and investment-grade credit ratings.

Analysts believe that the Treasury will unveil plans to show that the budget deficit will dip below 3% of gross domestic product (GDP) – a key level – over the coming three years, although it may take longer than predicted in the National Budget in February. It is also taken as a given that government debt will stay below the precarious level of 50% of GDP.

Through re-prioritising spending, the Treasury should also be able to come up with the estimated R2.5bn to R6bn that higher education minister Blade Nzminande has said is necessary to maintain a zero fee increase in 2017 for 70% of the students at universities and other tertiary institutions.

Blade Nzminande
Minister of higher education

There may be hints at measures which must be taken to raise additional tax revenue over the coming three financial years – 2017/18, 2018/19 and 2019/20, as the slowing economy takes a toll on the income streams needed for state coffers.

The medium-term budget policy statement (MTBPS) is not a forum for announcing new taxes, but Value-Added Tax is likely to go up next year, as it is widely seen as the most efficient way to boost revenue without inflicting pain on the private sector or the country's poor majority. At 14% it is low by global standards.

Political turmoil

But the real issue, unlikely to be resolved on 26 October, is whether the strategy crafted by Gordhan and his team will hold up against political wrangling within the ANC, which is losing credibility amid growing evidence of corruption, state capture and a significant loss of support at the recent municipal elections.

This concern has been highlighted by all three of the top rating agencies – Standard & Poor's (S&P), Moody's and Fitch – since President Jacob Zuma's shock dismissal of respected finance finister Nhlanhla Nene last December, and his brief replacement by Des van Rooyen, a little-known politician who lacked the experience or background for the post. Zuma was forced to reappoint Gordhan after domestic markets went into turmoil and the rand collapsed, but there is no guarantee that Gordhan will remain in his position during the coming weeks with charges of fraud – widely seen as trumped up – hanging over his head. In the present circumstances, Gordhan's removal would be seen as a blow to the integrity of the Treasury, and spur immediate credit rating downgrades.

President Jacob Zuma

That would substantially raise the government's cost of borrowing, which will make inroads into the money that would otherwise be spent on infrastructure and social programmes. It would also spark sales of domestic bonds and equities by investors, and send the rand into another tailspin.

According to research from Standard Bank, on the day the National Prosecuting Agency issued a formal summons against Gordhan, there were total outflows of R4.536bn, followed by R4.709bn the following day and R1.773bn the day after that.

Konrad Reuss
Sub-Saharan Africa managing director for Standard & Poor's

Ratings outlook

Konrad Reuss, the sub-Saharan Africa MD for rating agency S&P, warned at a conference in Cape Town on 13 October that the situation in SA was clearly "not business as usual" and it would be a mistake to downplay politics and political tension as just "noise".

"Here we really have political turmoil and political risk that can undermine structural reforms and the business climate and the investment climate, in a way that presents a serious risk to the South African credit story," he said.

He pointed out that SA's strong institutions – be it the judiciary, the Public Protector, the Constitution or the Treasury – have been "extremely strong underpinnings" for an investment grade rating of SA. "Any attempts to undermine these institutions – I think from

According to research from Standard Bank, on the day the National Prosecuting Agency issued a formal summons against Gordhan, there were total outflows of
R4.536bn,
followed by R4.709bn the following day and R1.773bn the day after that.

Gallo Images/Getty Images

Gordhan fought a long and bitter battle to replace the board of SAA to turn the airline around, and ended up with a compromise solution that saw the board replaced but the chair, Dudu Myeni, remain.

Pravin Gordhan
Minister of finance

a ratings perspective we would certainly see that as a negative."

These were ominous words as S&P has placed SA on the lowest rung of the investment grade ladder – with a negative outlook, which means that there is a good chance the next move will be downwards. Its rival Fitch has also given SA a BBB- rating, though with a stable outlook – and both are due to update their assessments on 2 December.

Moody's on the other hand, has SA given SA a rating two notches above junk status, though with a negative outlook. It will provide an update on 25 November.

"In many respects my sense is that the die is cast."

Former finance minister Trevor Manuel held out little hope that SA could avoid "junk status" in comments at a media event on 13 October. "In many respects my sense is that the die is cast," he said, highlighting that the state's contingent liabilities – guarantees to state-owned enterprises (SOEs) like Eskom and SAA – on their own were "not a happy side" to the balance sheet.

The contingent liabilities are seen as a major threat to SA's creditworthiness, and their status will be another closely watched feature of the MTBPS. In February, the Treasury said that guarantees to SOEs stood at R467bn in 2015/16, which ended in March, while total exposure – meaning the amounts which the entities have borrowed against – stood at R258bn.

Last month the Treasury extended another R4.7bn guarantee to SAA, which has clocked up losses of R7.1bn in the last two years alone. Gordhan fought a long and bitter battle to replace the board of SAA to turn the airline around, and ended up with a compromise solution that saw the board replaced but the chair, Dudu Myeni, remain.

Dudu Myeni
Chairperson of SAA

Excluding Treasury

Some analysts believe that the jury is still out as to whether the Treasury will get the political leeway to restructure the SOEs through streamlining and rationalising the state's holdings – part of a reform agenda seen as vital to spurring economic growth and boosting investment.

In August the Cabinet announced it was setting up a "Presidential State-Owned Enterprise Co-Ordinating Council" to provide Zuma with oversight on strategic decisions and interventions on SOEs – a move that sparked confusion over the reform process, as it was to have been overseen by the Treasury.

In the same vein, the Treasury was excluded from a ministerial task team set up earlier this month to help Nzimande deal with violent protests at universities and student demands for free university education – which would in total cost the government more than R60bn a year.

Excluding the Treasury from this process would make it more difficult for Gordhan to come up with a long-term strategy to address the problem, which will play a significant role in the country's budgets over the next few years, says Christie Viljoen, senior economist at KPMG Services in SA.

Nonetheless, some top executives still think that a downgrade to junk status is avoidable, and the medium-term budget will help to avert that outcome. "The narrative that all is lost on the ratings side is not valid from my perspective, though the political noise does not help," said Colin Coleman, a partner and managing director of Goldman Sachs in South Africa.

"We need continued focus, patience, and movement on structural reform." ■

editorial@finweek.co.za

Colin Coleman
Partner and managing director of Goldman Sachs in South Africa

market place

THIS WEEK:

>> **Killer Trade:** Retailer goes from strength to strength *p.21*

>> **Simon Says:** Comments on Adapt IT, Diamond Corp, Naspers, Steinhoff *p.22*

>> **Invest DIY:** Sussing out those 'known unknowns' *p.23*

>> **Pro Pick:** An opportunity in the vehicle industry *p.24*

>> **Investment:** The importance of diversification *p.25*

TASTE HOLDINGS

BUY **SELL** **WAIT**

By Simon Brown

Rapid cash burn is a very real risk

Taste's latest results indicate that the business still needs to get its new global brands kicking in and generating the generous profits one expects. The one shining light was the jewellery division, although how much of a kicker to profit growth was contributed by the newly acquired Arthur Kaplan is not disclosed.

Arthur Kaplan jewellery

The existing food brands grew at low single-digit numbers, which is certainly below inflation. The newly re-branded Domino's is picking up, but 17% growth is lower than I would expect for a global brand that is costing a packet to roll out.

Starbucks is doing well, but reserves remain a huge challenge for Taste. It has been burning cash at a rapid rate with the new brands, and cash could well run out by February. Taste's food division needs to start breaking even (it's currently losing money), while jewellery needs to continue its growth (typically the second half of the year is better for jewellery). The risks here are real and I would rather wait for the business to be significantly de-risked before taking a position. ■

Last trade ideas

BUY Metrofile
20 October issue

BUY Rolfes
13 October issue

SELL Choppies
6 October issue

SELL Astoria Investments
29 September issue

STEINHOFF INTERNATIONAL HOLDINGS

BUY **SELL** **HOLD**

By Moxima Gama

Muted sentiment might mean topping out

Integrated discount retailer Steinhoff, which raised €2.45bn in capital in September, announced another takeover deal on 14 October, this time to acquire Australian furniture retailer Fantastic Holdings for AU$316m (about $242.7m at the time of writing). Fantastic, with 126 retail outlets in Australia, is a "complementary business in terms of market segments, customer base and vertical integration", Steinhoff said in a statement. The deal will help Steinhoff to build scale and broaden its brand portfolio in Australia, where it already owns 157 retail outlets.

Steinhoff, which moved its primary listing to Frankfurt in December 2015, has been on an acquisition spree, with major recent deals including the $2.4bn acquisition of Mattress Firm in the US and the £610m acquisition of Poundland in the UK. It also acquired South Africa's Tekkie Town, with 302 retail outlets, in September. The value of that transaction was not disclosed.

Steinhoff's share price rose on the news of its Fantastic Holdings acquisition, but sentiment towards the announcement seemed muted, with the price possibly topping out.

How to trade it: Steinhoff has failed twice to trade above 9 500c/share – even breaching key support at 7 750c/share. However, it's currently undervalued or oversold, which should trigger a near-term recovery, possibly towards 8 740c/share. Failure to trade beyond that level could see it fall to 6 065c/share. Go short at a reversal below 8 740c/share after the anticipated recovery, and maintain a fair stop-loss. Failing that, a long could be initiated above 8 740c/share, as upside to 9 500c/share and then 9 700c/share (and possibly beyond) could be tested. ■

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Last trade ideas

HOLD Capitec Holdings
20 October issue

SELL Famous Brands
13 October issue

BUY Redefine Properties
6 October issue

BUY Brait SE
29 September issue

Steinhoff has been on an acquisition spree, with major recent deals including the

$2.4bn

acquisition of Mattress Firm in the US and the

£610m

aacquisition of Poundland in the UK.

arthurkaplan.co.za | Gallo Images/Getty Images

By Moxima Gama

PICK N PAY STORES

Nothing to frown about

This retailer is reaping the rewards of a successful turnaround strategy, having opened new stores, and growing turnover across the board both at home and north of the border.

Pick n Pay's latest results show that the retailer's turnaround strategy continues to bear fruit, with headline earnings per share up 23.7% in the 26 weeks to 28 August – its seventh consecutive reporting period of headline earnings growth in excess of 20%. Turnover grew 7.2% year-on-year to R34.9bn in the period, while trading profit was up 19.7% to R462.8m.

The retailer said it managed to grow sales despite the lacklustre economic growth and rising unemployment in South Africa, by opening new stores (74 new stores were opened, of which 36 are franchise stores) and offering value for cost-conscious consumers. Of the new shops, 23 were Express outlets to cater for the growing demand for convenience shopping, it said. The retailer also managed to improve its gross profit margin by 0.2 percentage points to 17.9%, partly thanks to greater cost and operational efficiencies, Pick n Pay said.

It also continues to focus on growing its stand-alone clothing and liquor stores, which remain a small part of the overall business but are seen as an important part of its growth strategy. Its clothing business sells over 8.5m units a year, and has seen sales growth of over 30% a year in the last three years in its stand-alone stores, Pick n Pay said. It now operates 159 stores. The value of its liquor business has more than doubled over the past five years, which saw the opening of 200 new stores, Pick n Pay said. Its liquor business now consists of 402 stores.

Its operations in the rest of Africa grew turnover by 8.2% in constant currency terms (growth of 4.4% in rand terms) over the period, with seven new stores opened in Namibia, Zambia and Zimbabwe. Pick n Pay now operates 137 stores in six countries on the continent outside SA, with plans underway to open stores in Ghana towards the end of 2017. In April, Pick n Pay announced a joint venture with AG Laventis, which is listed in Nigeria, to enter that West African market. The first store is likely to open in 2018, the retailer said.

Another key part of its turnaround plans is the roll-out of a centralised distribution system, which improves on-shelf availability of products and eliminates the need for substantial storage space at every supermarket. The level of centralised supply now stands at 65% in the Western Cape, and 64% in the inland region, Pick n Pay said.

52-week range:	R52.87 - R84.24
Price/earnings ratio:	28.25
1-year total return:	8.54%
Market capitalisation:	R33.1bn
Earnings per share:	R240
Dividend yield:	2.29%
Average volume over 30 days:	1 310 359

SOURCE: INET BFA

PICK N PAY STORES

SOURCE: MetaStock Pro (Reuters)

What next?

Possible scenario: In July Pick n Pay breached a significant trendline dated back to 2007, a move that could have placed it in medium-term bullishness. However, its sharp reversal through the 6 685c/share level could be a sign of a false break, which may well see Pick n Pay trade through its major support trendline (lower bold black slope). In other words, failure to recover beyond 8 485c/share should sound the alarm bells. With the three-week relative strength index (RSI) bouncing on its own support trendline, a recovery seems underway – signalled above 7 000c/share. But only upside through 8 425c/share would end the bearish speculation, and prompt gains towards 10 500c/share in the medium term.

Alternative scenario: A failed recovery above 8 425c/share would be bearish. Investors should reduce longs. A negative break out of the uptrend would be confirmed below 5 285c/share. ■

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Moxima Gama has been rated as one of the top five technical analysts in South Africa. She has been a technical analyst for 10 years, working for BJM, Noah Financial Innovation and for Standard Bank as part of the research team in the Treasury division of CIB.

By Simon Brown

Simon's stock tips

Founder and director of investment website JustOneLap.com Simon Brown is *finweek*'s resident expert on the stock markets. In this column, he provides insight into the week's main market news.

ADAPT IT

The Braes Adapt IT House in Bryanston, Johannesburg.

Quality stocks will reward patience

Having traded above 1 400c in late 2015, Adapt IT's share price was under pressure for much of this year. It traded down to 1 040c in May, causing many investors to worry about their investments. But the stock has since recovered and closed at an all-time high of 1 495c on 14 October. The lesson is simple but important. Short-term share prices will move around, and especially small-cap share prices can be impacted by volatility, with just a single large holder exiting making for a weaker share price. This often concerns smaller shareholders, but if the share is of a good quality and the underlying fundamentals remain in place, then price weakness is a buying opportunity and not a reason to worry. Working out whether the fundamentals remain intact is often tough, but in this case results for the company were solid, growth was happening and shareholders had no reason for concern. Always remember that price is just what we buy and sell at. What really matters is *what* we are buying or selling. If we're buying top-quality stocks, we can rest easy.

Adapt IT's share price was under pressure for much of this year. It traded down to **1040c** in May, causing many to worry about their investment.

DIAMOND CORP

A very real cash crunch

The flipside to Adapt IT is Diamond Corp, which saw its share price up at 262c in March and is now in desperate need of cash. If the company is unable to secure more cash, it will technically no longer be a going concern. This has sent the share price down to 32c, resulting in one potential provider of the cash to pull out. Here we have a share with very tricky underlying fundamentals. Mining is tough and always will be, and for small miners with a single mine it is even tougher. The prospects for this stock seemed solid back in 2013, but the miner continued to miss targets and this should have been a sign for investors to be very cautious, if not to exit. Now, with Diamond Crop facing a very real cash crunch, I would not want to be left holding this stock as the risks are very real.

If the company is unable to secure more cash, it will technically no longer be a going concern.

NASPERS

Cash doubled in eight years

Naspers* has announced the sale of its Polish unit Allegro for $3.253bn after having paid $1.485bn in 2008. For the year ending March, Naspers had cash and cash equivalents of just over $1.7bn, so this certainly adds significantly to its pile and should alleviate concerns about cash spending on ventures. However, I am surprised by the sale. Sure, it states that it wants to "unlock value for shareholders", but Allegro was a top business-to-consumer platform in Poland, with the other brands owned in the country being more consumer-to-consumer. But at the end of the day a more than doubling of your money in eight years is not shabby and Naspers did build up two very strong brands, OLX and PayU, so it remains a very strong player in Poland (also see page 26).

STEINHOFF

Too much, too quickly?

Steinhoff** continues its buying spree, this time picking up Australian company Fantastic Holdings for $275m. After the earlier sale of $2.69bn worth of Steinhoff shares to large investors, it certainly has the cash, but I wonder if this isn't maybe too much, too quickly. It also recently bought Poundland in the UK and Mattress Firm in the US. Yes, it has the cash, but acquisitions require time to work out and bed down, and dealing with three deals in three different corners of the world is not going to be easy. In defence of the company, most analysts (myself included) were not convinced when Steinhoff bought Conforama, yet that deal worked out brilliantly. But this rush to become a global discount company will have real challenges that increase the company's risk profile. ■

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*finweek *is a publication of Media24, a subsidiary of Naspers.*
***The writer owns shares in Steinhoff.*

Images: Getty Images/iStock Images

By Simon Brown

INVESTMENTS

Don't let the known unknowns catch you off guard

Aside from the recent developments concerning finance minister Pravin Gordhan, there are several other known factors that nevertheless make it difficult to predict what will happen with the economy. Sometimes one just has to wait and see.

Last week I wrote about former United States secretary of defense Donald Rumsfeld's quote about known unknowns and this week I experienced it in real life.

I sit on a local unit trust's investment committee. Once a quarter we meet and go over the portfolio, concerns and risks, and we consider what we should maybe be adding or removing from the fund. We're not micromanaging the unit trust. The fund manager has full discretion to do as he wants – the meeting is really just a sounding board and it includes internal staff and two outsiders, of which I am one.

Last week we had the meeting for the end of the third quarter of 2016. As always, those attending came up with a great many ideas, comments, views and opinions. But this time there was something very different – we made no decisions.

Yup, we sat around a table for over two hours and made not one decision. The reason is simple: uncertainty of forecast. In other words, there are so many unknowns we were unable to decide what to do. Importantly, these are known unknowns as we can see where the risks may be, but we're unable to know how they will play out and what impact they may have.

This meeting took place just hours after finance minister Pravin Gordhan had been charged to appear in court on 2 November, something that again tips the scales towards the likelihood of a South African downgrade to junk status by Standard & Poor's on 2 December.

But, in truth, our indecision was the result of much more than just the finance minister and junk status.

In one example we were discussing two stocks in the portfolio, both in the same sector. Both had recently released trading updates that both surprised on the downside. We were trying to determine whether we exit both, exit just one and move that free cash into the other, or whether we should just move the cash elsewhere.

We talked about this at length, but in the end we decided we simply didn't know enough and would have to wait for results to make a real decision.

Donald Rumsfeld
Former United States secretary of defense

Now sure, waiting for results is most often a good idea. But this is an experienced fund manager that has access to management and, more importantly, a very strong understanding of how the businesses operate and what their risks are. Yet in this case, even armed with that information, there were too many risks in the unknowns, even if we know what they are.

Now, turning to my own portfolio – it is clear that the fate of the finance minister is a major known unknown. We know he is under threat and we don't know what's going to happen, but importantly I think the latest actions against him significantly increase the odds of a downgrade. So here we have an unknown (will the minster be charged and/or released from his duties), but we know that whatever happens, the rating agencies will be taking a very dim view.

> **We know he is under threat and we don't know what's going to happen, but importantly I think the latest actions against him significantly increase the odds of a downgrade.**

Pravin Gordhan
Minister of finance

This has been a known unknown since December last year and I have spent much of the last December reducing my portfolio's exposure to SA Inc. stocks. Sure, many of the stocks I have exited are above my sell price. But investing is a long-term game and it is mostly about managing risks, and the risks remain real as indicated by Gordhan's summons to appear in court.

We need to have long-term, resilient portfolios that look beyond the immediate noise, consider the bigger picture and that can weather any storms that come their way. In order to make sure our portfolios meet these requirements, it is critical that we watch the known unknowns very carefully. ■

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Images: Getty Images/Gallo Images
Getty Images/Riccardo Savi/Concordia Summit

By Dr Andrew Dittberner

CMH

A misunderstood opportunity

Combined Motor Holdings suffers from the market misconception that its business is directly correlated to the economic environment, and new vehicle sales in particular.

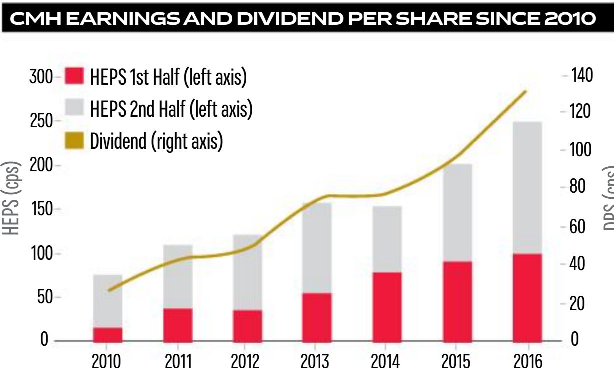
Possibly one of the most misunderstood shares on the market, Combined Motor Holdings (CMH) presents an exceptional opportunity at current levels. While the company operates at the sharp end of the economy, there is a misconception that this business is directly correlated to the economic environment, and new vehicle sales in particular.

While CMS is largely thought of as a motor vehicle retailer, it is important to realise that motor dealerships derive a large portion of their incomes from aftermarket servicing, as well as used vehicle sales, as opposed with just new vehicle sales. As such, recent new vehicle sales numbers should not be seen as a leading indicator for CMH's earnings. Evidence of this can be seen in the company's recently released trading update indicating that for the six months ending August, headline earnings per share (HEPS) is expected to be up between 15% and 25%. Those numbers are a far cry from Naamsa's recently published new vehicle sales, which show a sharp decline.

Alongside the dealerships, CMH also owns First Car Rental, a proudly South African car rental company that has been in business for over 17 years. First Car Rental has delivered excellent performance over a number of years, with earnings having enjoyed an average annual compounded growth rate of 28% since 2008. Unsurprisingly, First Car Rental contributed 24% of group operating profits at the 2016 full-year results, released earlier this year. The business proposition of owning First Car Rental is enhanced by the group's ability to sell new vehicles to First Car Rental, as well as selling its used vehicles.

On the vehicle distribution front, 68% of group operating profit came from this division. Within that, typically 40% comes from parts and servicing, while 35% reflects new vehicle sales and 23% is from used vehicle sales. Thus new vehicle sales typically account for only 24% of group operating profit. The final leg of the business involves financial services, which assist buyers with financing their purchases.

The current economic environment is conducive to vehicle owners either trading down top-end vehicles to purchase more affordable models, or alternatively purchasing used vehicles. As such, used vehicle volumes tend to be counter-cyclical. Evidence of this can be seen from the fourth-quarter volumes in the last financial year, where used vehicle volumes were up 21.3% compared to the same period the previous year. Given the shortage of quality used vehicles in the country at the moment, this trend is expected to continue in the current financial year.



Considering that the purchase price at the beginning of 2010 was R7.95, investors have received their original investment back in the form of dividends and share buybacks.

www.insurancechat.co.za/First Car Rental

From an investment perspective, CMH is a fantastic long-term option. Looking at recent history, since 2010 HEPS have risen at a compounded average annual rate of 22%, complemented by a five-year average return on shareholder's equity of 27.9%. The earnings, which are also of a high quality, are backed by cash flows.

Over this five-year period, the company has repurchased an effective 33.5% of total outstanding shares, while paying R4.95 in dividends back to shareholders. Considering that the purchase price at the beginning of 2010 was R7.95, investors have received their original investment back in the form of dividends and share buybacks.

In 2010 CMH traded on a price-to-earnings ratio (P/E) of 14 times with a dividend yield of 2.4%. Today, I would argue that CMH is far more attractively priced than it was five years ago. Admittedly, the business is highly working-capital intensive; however, the long-term debt is negligible, and cash on hand is R500m, which is substantial for a R1.3bn market capitalisation business. Trading on a P/E of 6.6 times and a dividend yield of 6.8%, if history rhymes, investors will be handsomely rewarded. ■

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Dr Andrew Dittberner is chief investment officer of Cannon Asset Managers.

By Schalk Louw

PORTFOLIO MANAGEMENT

Adding clubs to your investment bag

Many investors stick to only one or two asset classes, but proper diversification requires a broader look than that.

Imagine for a moment that Ernie Els arrives at next year's SA Open with only one golf club. It won't matter how good the Big Easy is, there is just no way he will be able to win such a big tournament with only one club. Every stroke requires a different club, therefore he will need a set of clubs in order to have a fighting chance of winning the tournament.

Investments operate on much the same principle. Because shares as an asset class have delivered the highest returns over the years, I sometimes find it challenging to convince an investor that they also have to look at other asset classes such as bonds, the money market or property as investment options.

When we take a look at the risk-versus-returns aspect of such an investment, however, we will see that although shares may have delivered greater returns, it also came at a much higher investment risk. Taking control of your investment portfolio starts with determining your personal risk profile. Even though the long-term returns on shares have outperformed the returns on other asset classes, few investors can really afford to invest all of their money in shares alone.

Even though the long-term returns on shares have outperformed the returns on other asset classes, few investors can really afford to invest all of their money in shares alone.

It is often the most vulnerable investors, such as pensioners, who require an income and stability from their capital, who are seldom able to invest in shares, but then also find themselves in financial trouble because of the fact that money market investment returns have a hard time keeping up with inflation after taxes. Many investors then turn to income funds as an alternative in order to earn an extra percentage point or two on their investments.

Income funds are usually recommended for investors with a primary need to protect their capital and a secondary need for income generation. To protect investors against capital erosion, these funds mainly focus on the more conservative asset classes such as the money market, bonds, property and high-dividend shares.

The money market and bonds ensure capital preservation, which is supplemented by conservative interest and coupon payment. Property shares and high-dividend shares offer a riskier addition to a conservative income fund, which in turn offers less security in capital preservation but aims to deliver higher long-term capital growth.

The optimal mix of these four asset classes will be determined by the nature of the fund and the fund manager's strategy, and although capital growth is much more limited compared to shares and balanced funds, this type of investment can still be a valuable addition to any investor's portfolio.

When we take a look at the list of available South African income funds (unit trusts), we will see that their historical earnings weren't much higher than money-market returns over the past 10 years (up to October 2016), as income funds only outperformed the money market by an average of 0.79% per year over this period. Even by focusing on the past three years alone, the approximately 1% higher return that income funds have delivered compared to the money market barely seems worth the effort.

What investors often forget, however, are the costs involved in investments. The current average total expense ratio (TER) on income funds amounts to 1.14% per year. At an average rate of 8.94% on the SA All Bond Index, investors can expect to earn around 8%, which isn't that much higher than current money-market rates.

The current average total expense ratio on income funds amounts to 1.14% per year. At an average rate of 8.94% on the SA All Bond Index, investors can expect to earn around 8%, which isn't that much higher than current money-market rates.

But investors can invest in these asset classes in their personal capacity, and save a considerable amount in costs in the process. The fact that bonds trade in blocks of R1m doesn't mean that investors cannot purchase smaller units. I've seen investors invest as little as R50 000 in government bonds.

What makes these investments so interesting is firstly the fact that it is relatively cheap when compared to shares (at an average of R800 per transaction per R1m block of RSA government bonds, with a minimum of R500 per transaction), and secondly it is extremely simple. If you would like to purchase R100 000 in government bonds, it will cost you R500 in purchasing costs (or 0.5% of your capital). Of course this doesn't make bonds a better investment than shares, but as I mentioned in my Ernie Els analogy, different clubs are required for different shots. These funds are to the disposal of every investor – be sure to include them to get the best out of your investment portfolio. ■

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Gallo Getty Images/iStockphoto

THE SKY'S THE LIMIT

By Lloyd Gedye

Naspers has grown phenomenally since it was founded just over a century ago. We chat to the CEO of Africa's biggest company to find out where this behemoth is headed.

NASPERS

Tying down Naspers* CEO Bob van Dijk for an interview is tough going.

When *finweek* did manage to get him on the other end of a phone line a few weeks ago, he admitted he was taking a break during transit to chat.

With Naspers's presence in more than 130 countries, one would expect that travel is par for the course for the CEO. After all he is at the helm of Africa's largest company, with a market capitalisation of over R1tr, a feat achieved in June this year.

Only three companies listed on the JSE had reached this size before: beer giant Anheuser-Busch InBev (R3.1tr), British American Tobacco (R1.9tr) and SABMiller (R1.6tr).

In the last five years the Naspers share price has risen by **504%.**

When Naspers listed in 1994, its market capitalisation sat at $622m, compared with $70.4bn at the time of writing on 17 October.

Naturally it's been quite a ride.

In the last five years, the Naspers share price has risen by 504%, according to INET BFA data. In the last year it has grown by 18.3%, reaching a high of R2 530 a share in September this year. It was trading at R2 294.99 at the time of writing.

The company, founded in Stellenbosch in 1915, today earns more than half of its consolidated revenue from outside South Africa. It has stakes in over 40 businesses in more than 130 countries, across the financial payments, media, online retail, classifieds, education, travel and tourism sectors.

Van Dijk was appointed Naspers CEO on April Fool's day in 2014. He replaced current Naspers chair Koos Bekker, who had been the CEO since 1997, the same year Van Dijk began his career as a junior associate at global management consulting firm McKinsey.

By July 2004 Van Dijk was working at eBay as a finance and strategy manager.

He would rise up the ranks, occupying the seats of vice president of eBay Europe and managing director of eBay Netherlands, along the way.

Naspers chair Koos Bekker once famously described him as "the best e-commerce man in the world".

But Van Dijk hadn't always been the anointed successor to Bekker.

Antonie Roux, the head of the Naspers internet division, was widely tipped for that role, but he passed away suddenly in June 2012, at the age of 54. Roux had been in charge of the internet division for the last decade and had been at Naspers since the late 1970s.

Roux and Bekker had travelled a long road together. He was, alongside Bekker, a co-founder of pay-TV subsidiary M-Net in 1985. M-Net would later expand into pay-TV giant MultiChoice, a cornerstone of the Naspers empire.

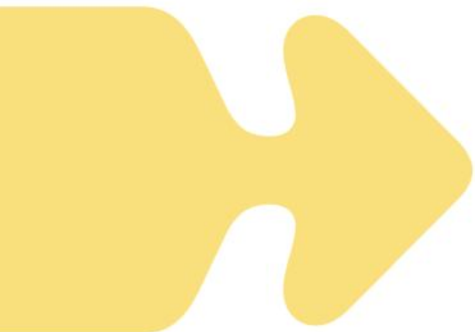
Van Dijk says his first two years at the helm of Naspers have been an "interesting ride".

"Markets are moving at incredible pace," he says. "At the same time the environment is becoming more competitive. Companies with a global presence are becoming smarter and more strategic."

Van Dijk singles out players like Facebook, Amazon and Google as Naspers's key competitors. "They are taking their slice of advertising revenue and are investing it in growing new businesses."

Bob van Dijk
CEO of Naspers

Gallo/Getty Images



Koos Bekker
Chair of Naspers

"The reality is that sub-Saharan Africa has had a tough time over the last 12 months, facing collapsing commodity prices and the affects that this has on its currencies."

Facing headwinds

In August this year, Naspers held its 103rd annual general meeting (AGM) at the Media24 head office in Heerengracht Street, Cape Town.

Despite reporting a 10% decline in consolidated revenue, to $5.9bn, and after-tax profit falling 20% to just over $1bn for the year to end March, the group insisted that it had announced a "solid" set of results, considering the "volatile" macroeconomic backdrop. (Core headline earnings, which are adjusted for e.g. the amortisation of intangible assets, equity-settled share-based payment expenses and currency translation differences, and which the board sees as a more accurate measure of Naspers's performance, was up 21% to nearly $1.3bn.) At the AGM Bekker, now chairman, said that the "headwinds" that Naspers was facing would still be with it in 2017.

The main challenge has been the performance of its cash-generative and traditionally very lucrative pay-TV operations in SA and sub-Saharan Africa, where weak economic growth and a substantial weakening of domestic currencies weighed on demand and the division's financial performance. As a result, the video entertainment division saw its revenue (which includes equity-accounted investments) decline 11% to $3.4bn in the past financial year, while trading profit was down 17% to $610m.

Van Dijk says while its costs in the satellite television and video on demand markets are based in US dollars, customer subscriptions are charged in local currencies on the African continent, which means these businesses have been exposed to the currency volatility.

Naspers had to increase prices to offset the impact of weakening local currencies on its profitability (a large component of the division's cost base is denominated in US dollar), resulting in a loss of 288 000 subscribers. In SA, the customer base grew by 325 000.

"Koos was speaking about the toughening trading conditions in sub-Saharan Africa," says Van Dijk. "These challenges are not going to go away overnight. We've fared well over the last two years, but the reality is that sub-Saharan Africa has had a tough time over the last 12 months, facing collapsing commodity prices and the affects that this has on its currencies."

Outlook downgrade

In August, S&P announced it was downgrading its outlook on Naspers from stable to negative, citing challenges faced by its pay-TV business. The ratings agency affirmed Naspers's BBB- long-term corporate credit rating, as well as its BBB- rating on Naspers's senior unsecured debt instruments. BBB- is S&P's lowest investment-grade rating.

"The outlook revision reflects our view that Naspers's profitability will weaken in the 2017 fiscal year following its lacklustre reported revenues and profitability in 2016," said S&P.

"Slower organic growth in its cash-generative video entertainment operations and its limited ability to quickly adjust its cost base, which bears significant exposure to the US dollar, are the main reasons behind the expected weaker performance," it said.

Van Dijk says the outlook downgrade on Naspers by S&P was purely based on the tough regional market conditions and does not reflect on the quality of the businesses that fall under the Naspers group.

Liam Hechter
Analyst at
Anchor Capital

Jean Pierre Verster
Portfolio manager at
Fairtree Capital

Outlook for pay-TV

Jean Pierre Verster, portfolio manager at Fairtree Capital, says these headwinds are expected to be with Naspers for a while longer.

Anchor Capital analyst Liam Hechter says pressure on Naspers pay-TV business should be expected, as it is largely a discretionary item and has become quite expensive in SA for most households (R759 a month for Premium Bouquet).

"However, I think this needs to be placed in context of the broader Naspers group – even with fairly generous assumptions, the group's pay-TV business probably accounts for about R300 a share of value, so it is not even close to being a core driver of value anymore," said Hechter.

Van Dijk says its internet video streaming business ShowMax, which rivals Netflix, is growing strongly. "It is ahead of our projections so far," says Van Dijk about the business, which was launched in August 2015.

He says the plan was to get it into the market quickly and learn and refine it along the way. This was the correct decision as Naspers gained first-mover advantage in the market by launching before Netflix did in SA (in January 2016), but it has also resulted in a much more effective product offering, Van Dijk believes.

In September, ShowMax entered into a partnership with Telkom to zero-rate the data costs for ShowMax subscribers who choose a bolt-on package from Telkom at R99 a month.

"Many people don't have an uncapped data package, so data costs are an issue regarding video on demand," says Van Dijk. "In South Africa data is not cheap, we wanted to find a way to solve this for our customers."

INDIA RISING

With India having the second-largest population of the world – estimated at 1.3bn people – it's only natural that Naspers would be interested in doing business there, Van Dijk says.

"We have been investing there for a long time," he says. "But the investments always took longer to reach maturity. Three years ago that changed completely."

A decade ago, India only had 10m internet users, which may sound like a lot, but this figure represented only about 1% of the population; four years ago it had grown to three to four times that number.

But then, thanks to the rapid growth in mobile use and the subsequent increase in internet users, this figure is currently closer to 400m. The market had expanded 10 times in three to four years. "India has just exploded," says Van Dijk.

In 2007 Naspers backed Ashish Kashyap to found India-based greenfield incubator Ibibo Group. Ibibo's businesses include redBUS, India's leading online bus ticketing service, GoBibo, a travel booking application, and a 51% stake in Travelboutique Online, which offers booking services for bus ticketing and international flights. This makes Ibibo the largest travel player in India.

The group announced on 19 October that it will combine Ibibo with US competitor MakeMyTrip in exchange for new shares, which will give Tencent and Naspers a combined share of 40% in MakeMyTrip, Bloomberg reported.

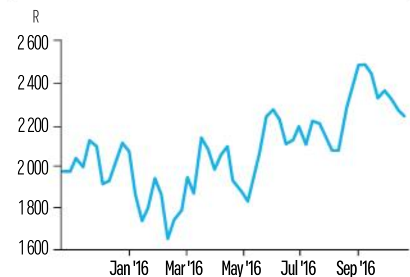
Ibibo Pay, which was launched in 2010, has since been rebranded PayU India. Last month, PayU announced that it was acquiring a third of Indian payments company Citrus Pay for $130m. This deal is still subject to approval.

The transaction will expand Pay U's footprint in India, bringing 30m customers and a projected 150m transactions in 2016 worth $4.2bn. Both companies offer digital wallet services, but the market is dominated by PayTM, which is also raising capital for expansion.

Naspers has also invested in Flipkart, India's largest online retailer, initially buying a 10% stake for $102.1m in 2012. "It does what Takealot does in SA," explains Van Dijk. Naspers currently owns a 15.83% stake in the business.

Fairtree Capital's Jean Pierre Verster says the investment in Flipkart and other Indian operations is a meaningful part of the Naspers investment case, and the fact that the group didn't follow the most recent additional investment rounds in Flipkart indicates capital discipline in a very competitive market. ■

NASPERS



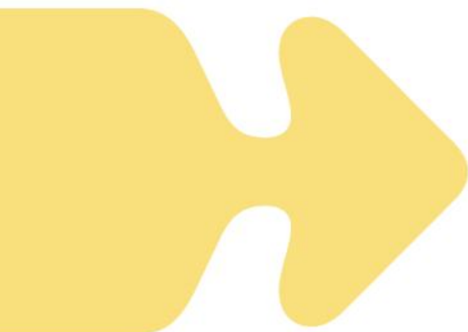
52-week range:	R1 685.94 - R2 553.59
Price/earnings ratio:	100.14
1-year total return:	20.24%
Market capitalisation:	R1.025tr
Earnings per share:	$1.68
Dividend yield:	0.21%
Average volume over 30 days:	1 940 727

SOURCE: INET BFA

TENCENT

52-week range:	HKD132.10 - HKD220.80
Price/earnings ratio:	49.94
1-year total return:	45.09%
Market capitalisation:	HKD2.014tr
Earnings per share:	3.70 yuan
Dividend yield:	0.22%
Average volume over 30 days:	7 582 360

SOURCE: INET BFA



The value of the Tencent share means that Naspers is trading at a "significant discount to its sum of the parts", and that there is still "ample reason to be bullish on Naspers".

Revenue from Naspers's internet business, including equity-accounted investments, rose 18% to $8.2bn, with Tencent accounting for $5.4bn, an increase of 26%. The media business, historically print media, saw revenue decline 20% to $29m.

Van Dijk says Media24 is doing great in the context of print media being under pressure globally. "They have delivered profit in spite of that."

The US venture capital office

So where is Naspers heading?

"Naspers will be a purely online player in the future," says Van Dijk. "That's where the company is going."

He says that local print media business Media24's shift to a web model and the launch of ShowMax in the video-on-demand market are two examples of how the group is shifting its businesses online.

Van Dijk feels he is perfectly placed to lead the company during this shift, describing himself as a child of the "online experiment".

"I grew up in it," he says.

In December last year Naspers raised $2.5bn from shareholders to fund acquisitions ($1.2bn of the proceeds was used for the acquisition of a controlling stake in Avito, Russia's largest classifieds site), and in May this year it opened a venture capital office in San Francisco.

"We have always spent a lot of time in the Bay area," says Van Dijk. "A lot of great companies start out of the Bay area. But what Naspers brings is it's a global player with operational experience in many markets and countries.

"We are looking for new business that are strong on technology and are consumer focused. [...] Early-stage companies with global potential," he says.

Fairtree Capital's Verster believes a presence in San Francisco is important "in order to be near the epicentre of innovation in the internet space".

Anchor Capital's Hechter agrees: "One needs to have a presence where the action is happening, to be able to attract and retain the best talent, source the best deals, and stay on top of the latest developments."

Betting on education

Naspers kicked off its presence in Silicon Valley with a $15m investment in social learning network Brainly in May, the group's first investment in the educational technology (EdTech) space. At the time, it said more than 60m students in 35 countries interact with Brainly every month.

In June, Naspers announced a $60m investment in Udemy, a San Francisco-based online learning and teaching business which offers more than 40 000 courses globally in 80 different languages, through its Naspers Ventures division. In July, it invested $30m in New York-based Codecademy, which was founded in 2011 to provide "a path for learners to become coding experts without attending a traditional educational institution, which could be a game-changer in developing countries", Naspers said at the time.

Van Dijk says it is predicted that the world will need 10m to 20m new software engineers in the future, but that universities can only produce 10% of

In June, Naspers announced a

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40 000

courses globally in 80 different languages, through its Naspers Ventures division.

that, meaning there is going to be a massive shortfall.

The segment where technology and education meet is "fascinating" to Naspers, Van Dijk says. "Education is a big area where people spend their time and money," he says. "How does technology transform this?" he asks rhetorically.

A growing classifieds giant

Online classifieds giant Craigslist is one competitor on which Van Dijk, who describes the business as "clunky", has his sights firmly set. He says mobility is a key trend going forward and the fact that Craigslist has not launched a mobile app makes it a target to steal market share from.

Naspers believes new mobile application letgo has what it takes to rattle the cage of America's number one classifieds website. Naspers invested $100m last in year in letgo, which was founded by entrepreneur Alec Oxenford and targets the US market. Oxenford was a co-founder of classifieds website OLX, which was founded in 2006 to provide an online classifieds platform for developing markets. Naspers acquired the company, which is now the largest classifieds business in India and Brazil, in 2010.

"He [Oxenford] is an excellent entrepreneur," says Van Dijk. "He understands classifieds in just about every market in the world." Oxenford recently reported that the new application had 5.5m postings in July 2016.

Verster says the letgo investment is an important test for Naspers to see if it can compete against the large incumbents such as Craigslist.

In October 2015 Naspers bought a majority stake in Russia's Avito for $1.2bn, upping its stake from 17% to 68%. The deal appeared a wise move when five months later the website announced a 55% rise in sales.

Avito allows customers to sell possessions online and with the tough economic conditions Russia faces, where consumers are cash-strapped, many citizens have been inclined to sell possessions to bring in money and shop for second-hand goods instead of new ones.

Naspers also owns a 29% stake in

Tencent's new headquarters in Shenzhen, China.

Gallo/Getty Images

Mail.ru Group, Russia's largest operator of social networks. The division contributed $173m to revenue in the past financial year, a decline of 18%.

It was deals like investment in Mail.ru and the Chinese internet giant Tencent that fuelled Naspers's growth over the last decade.

A decade fuelled by Tencent

In 2001 Naspers paid R34m for a 46% stake in Chinese internet company Tencent Holdings. Its holding shrank to 34% after Tencent's initial public offering in 2004, but that stake was worth $86.7bn (or R1.16tr) at the time of writing, exceeding Naspers's market capitalisation.

This has led to some calls from analysts for the stake in Tencent, which became the most valuable company in China in September, be unbundled to unlock value for shareholders.

"We have no intention to do any unbundling," says Van Dijk. "It's not up to us to guess what the market is doing."

Verster says the value of the Tencent share means that Naspers is trading at a "significant discount to its sum of the parts", and that there is still "ample reason to be bullish on Naspers".

Hechter says Naspers remains the largest holding in most equity portfolios in SA and he would rate it a buy. "This is partly explained by the relative size of Naspers in the index and in part explained by the solid fundamentals of the largest underlying investment, Tencent," says Hechter. Of the seven analysts polled anonymously by INET BFA, all seven rate the stock a buy.

"Tencent is still in the heart of a structural growth phase and trades on an undemanding 30 times our estimate of forward earnings," he says. "We are comfortable with the valuation of Tencent as a stand-alone investment, which makes the discounted entry via Naspers an even more attractive investment proposition."

Van Dijk says Tencent was a "fantastic investment", and that Naspers was "fortunate to work with a team to build a business like that".

He believes you can't go looking for a new Tencent, which he describes as a "once in a lifetime" opportunity. "It doesn't exist," Van Dijk says.

The idea is for Naspers to keep reinventing itself in order to remain relevant. ■

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*finweek *is a publication of Media24, a subsidiary of Naspers.*

CO-WORKING: ‘A REVOLUTION IS STIRRING’

The concept of co-working spaces is taking root in South Africa – and it offers to unlock tremendous potential for innovation and growth.

By Sean Christie

Workshop 17, a partnership between OPEN and the V&A Waterfront.

Images supplied

When co-working began to take off in Cape Town and Johannesburg roughly four years ago, the major commercial property players did a very good job of projecting disinterest. As the spokesperson for a big multinational commercial property enterprise told this author last year: "We can't really identify the business in it. We offer it, but compared to core business it's a drop in the ocean."

But by now it has become clear that some of the major landlords are indeed interested. OPEN, which operates co-working spaces in Johannesburg and in Cape Town's V&A Waterfront, is in the final stage of forging a partnership with a major property company. The deal will see co-working hubs established in multiple areas, totalling some 20 000m^2 of space. At the corporate end of the serviced office space spectrum, Redefine Properties announced a partnership with global flexible workspace company Regus in mid-September. This will see Redefine offering 4 500m^2 of "competitive and flexible workspace solutions" across seven sites in Johannesburg and Cape Town.

These are not big deals – toes in the water, at most – but they could very well be the harbingers of a significant change. Paul Keursten (co-founder of OPEN), certainly thinks so. "I think the co-working revolution is stirring and will only grow from here."

Total re-imagining required

"Data, software and the uptake of smart devices have fundamentally changed the ways in which we work, but the spaces in which we work haven't adapted. Everywhere you look offices are being renovated, but this generally means little more than a facelift and the introduction of a coffee bar. What is required – what is inevitable, I would argue – is a total re-imagining of workspace."

Keursten's views are in line with the World Economic Forum's January 2016 *The Future of Jobs* report, which has 44%

Paul Keursten
Co-founder of OPEN

"What is required – what is inevitable, I would argue – is a total re-imagining of workspace."

of all respondents (amongst them the biggest employers in the world) naming "changing work environments and flexible working arrangements" as the "major driver of change" in their sectors.

The report asserts that "application of technology has already changed when and where work is done in practically every industry, as workplaces of the industrial age give way to work practices of the digital age, including remote work, flexible work and on-demand work. Organisations are likely to have an ever-smaller pool of core full-time employees for fixed functions, backed up by colleagues in other countries and external consultants and contractors for specific projects."

Ian Merrington, CEO of the Cape Innovation and Technology Initiative (CiTi), which offers co-working opportunities via an initiative called The Barn Woodstock, said that while he believed "co-working is going to be massive", it was important to distinguish between divergent strategies within the co-working movement. "Co-working as most know it is actually quite bland," he says.

"You have space, chairs, fast internet and good coffee. It's just a real estate play, really, and while I believe there will be room for all players within the co-working phenomenon, those who are merely in the business of providing co-working space will settle somewhere near the bottom. Bandwidth doesn't set anyone apart anymore. The initiatives that will drive the co-working movement, I think, will offer much more in the way of value-added services," he says.

CiTi, founded in 1998 with the aim of developing "Cape Town and the region as a global technology cluster and a vibrant hub for innovation", is putting its energy into the establishment of sector-specific hubs for business incubators, accelerators and start-ups, the basic idea being that similarly-able minds can't help but feed off each other, and that the right mix of energy and ability in the right environment is what creates future-defining ideas and technologies.

The strategy grew out of CiTi's own experience of seeing one of its initiatives, The Bandwidth Barn (now The Barn Woodstock), become the continent's major hub for fintech incubators and start-ups.

"Look at any sector – banking, legal, medicine, education – and you find business leaders looking terribly short of sleep because they've been fretting about the pace of technological change," says Merrington.

"They know they're finished without software, and they're equally aware that developing these tools in-house is fantastically complex and expensive. So they're looking for outside help, increasingly, and this has created unprecedented opportunity for tech start-ups," he says. He adds that the extraordinary pace of technological change had given rise to "liberal new attitudes towards the sharing of intellectual property, which many above a certain age find quite alien".

"The banks fell behind because they grew these secretive, isolationist cultures," he explained.

"Tech start-ups, by contrast, look to situate themselves within mutually supportive ecologies, knowing that collaboration unlocks creativity. We seek to meet these needs by pulling the best and the brightest per sector into synergistic hubs, where the real value addition lies in the access to brilliant minds and complimentary skill sets," he said.

OPEN is also in the business of growing collaborative communities, but where CiTi focuses on creating niche hubs, OPEN believes in the power of diversity.

Ian Merrington
CEO of the Cape Innovation and Technology Initiative (CiTi)

"We cater for a variety of incubators, accelerators, companies, start-ups and individuals, by offering a mix of dedicated workspace, eventing facilities, co-working areas and labs. We treat everyone the same, whether you're a student or a CEO," he says.

"A big inspiration for us is the work of Steven Johnson, author of the book *Where Good Ideas Come From.* He begins with the example of the coral reef, and explains that so much life flourishes in these spaces because the coral reef is a non-judgmental system in which a variety of species live in close proximity. It's a fertile ground of equal opportunity, and we take that as a metaphor. What the coral reef is to sea life we want to be for human ideas and innovation." He adds that he and his partners invest a great deal of energy into maximising, through virtual and physical design, the possibilities for interaction between OPEN members.

"Therein lies the major value-addition: the opportunity to meet and interact with interesting people in a high-trust environment," he says.

Value in communities

From a traditional money lender perspective OPEN's model is problematic to finance because it is reliant on flexible memberships for income, which can be cancelled at any time. But Keursten believes that this thinking fails to attach value to communities.

"If a community is thriving it will grow itself. In that sense it's like software: if you have a great platform, and it creates traction, you will attach a higher value to it. We're like the software of property," says Keursten, who might well have had in mind the example of shared office space start-up WeWork Cos., which in March claimed a company valuation

What is co-working?

Writing in the Harvard Business Review, Gretchen Spreitzer, Peter Bacevice, and Lyndon Garrett defined co-working as "membership-based workspaces where diverse groups of freelancers, remote workers, and other independent professionals work together in a shared, communal setting".

Images supplied

"We're like the software of property," said Keursten, who might well have had in mind the example of shared office space start-up WeWork Cos., which in March claimed a company valuation of

$16bn,

vastly more than a host of more traditional landlords with far larger property holdings.

of $16bn, vastly more than a host of more traditional landlords with far larger property holdings. WeWork's extraordinary ability to attract funding has been attributed to the interconnectedness of WeWork members, and the shared belief that they represent a new and improved way of doing things.

OPEN's strategy for the next three years will see the establishment of a triangle of co-working hubs in Cape Town, Paarl and Stellenbosch, and in nodes along the Gautrain routes, and in Durban. Co-working hubs are also planned for Philippi and other less privileged areas.

"Incredible things happen when people from different backgrounds collide," said Keursten.

"One of our members is a coding school (codeX) mainly for people from previously disadvantaged backgrounds," according to Keursten. He says instructors have found that these students approach projects differently to people from affluent backgrounds. "They factor in the user experience in poorer communities, and that's obviously a major advantage in the development of applications for this market. As more communities are connected, I think you will find more and more of this country's potential becoming unlocked," he said.

Keursten's optimism is commendable, but it remains to be seen which of the many co-working models will find real traction in South Africa. **That said, the success stories both locally and internationally all share the following aims:**

- They put a lot of stock in user friendliness, offering all the features you'd find in a triple A grade office, in terms of lighting, acoustics, internet speed, ergonomics, coffee and more.
- They don't see themselves as landlords, merely renting chairs, but aspire towards the creation of physical and virtual communities.
- And they look to offer value-addition that goes well beyond good coffee and a communal foosball table. This can be in the form of mentorship opportunities, workshops or inter-member offers such as flight and stationary discounts. It can be in the form of lifestyle enriching events such as book clubs, technology talks and movie nights. And on the less tangible side it can lie in the synergy between members – that alchemical something that helps to produce best-in-class products again and again.

If this doesn't sound remotely like your own work reality, there's a good chance you're being held back on a number of levels. ■

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OPEN's Workshop 17 at the V&A Waterfront in Cape Town.

Cape Town in the lead

The Mother City is the undisputed African capital of co-working, with dozens of co-working spaces opening doors in the last few years. There's even a WiFi-enabled workspace at the top of Table Mountain, where entrepreneurs can work for free on Tuesdays.

And while some might be tempted to link the trend to the famous cape affinity for easy work terms, Tim Harris, the CEO of the Western Cape Investment and Trade and Promotion Agency (Wesgro), feels the proliferation of co-working spaces is bound up with the fact that Cape Town is also Africa's leading city for start-ups.

"Cape Town has a well-established reputation for creativity, and when innovative co-working initiatives started appearing this undoubtedly increased the city's attractiveness to start-ups, which are drawn towards this kind of energy. The growing number of start-ups has in turn pushed the demand for co-working space," he said.

Harris added that global multinationals had begun, "tapping into the innovation coming out of Cape Town's co-work spaces".

"Barclays Rise, an acceleration centre for fintech entrepreneurs, recently launched its fourth global site at the The Barn Woodstock, and that project has attracted approximately R15m in investment far. Thompson Reuters also selected Cape Town over other African cities to become the host of its African innovation lab, Thomson Reuters Labs," he said.

Cape Town has also been exporting co-working know-how to other African cities. When he was tasked with opening up an office for a multinational company in the Angolan capital of Luanda, Capetonian Michael Sternberg found that good office space was scarce, extremely expensive and available only on onerous terms.

"I had spent some time in co-working spaces in Cape Town, and came to appreciate three major advantages, which are that your costs are lower, you don't have to worry about paying for utilities or office staff and you're always surrounded by a supportive community. This is exactly what I had been looking for in Luanda, so after completing my project there I set up The Launchpad in central Luanda, Angola's first co-working space, targeting foreign investors," he said.

Sternberg said he planned to establish co-working spaces in other parts of the city, before expanding to Angola's provinces.

"The connection to Cape Town might seem light, but in fact Luanda is one of the only international cities you can fly to directly from Cape Town. Cape-based South African retailers are also thick on the ground there, and the plan is to ultimately offer co-working passports, where members of co-working spaces in Luanda and Cape Town will have access in both cities," he said. ■

INSIDE THE CHEMICAL GIANT'S $11BN GAMBLE

By Jana Marais

Sasol is betting the farm on a new $11bn chemicals plant in Lake Charles, Louisiana – one of nine new plants under construction in the Gulf of Mexico area alone – to take advantage of cheap natural gas in the US. Will the gamble pay off for investors?

Driving around Sasol's Lake Charles Chemicals Project (LCCP) site in Lake Charles, about 225km east of Houston, it is easier to swallow the massive cost overruns and delays on the project, which have led to much criticism from analysts and fund managers.

The scale and complexity of the complex, which will include a 1.5m-ton-per-year ethane cracker (used to produce ethylene, the key building block to produce a range of chemicals), and six downstream chemical production facilities, is simply mind-boggling. About 4 400 construction workers are currently on site, and as of September more than 17 250 piles had been installed, nearly 70% of the total required.

At the time of the visit early in October, construction was about 15% complete, although the project overall (including engineering work and the purchase of equipment) stood at just over 50% completion. To date, about $5bn has been spent.

Originally estimated to cost between $7bn and $9bn when the project was first announced in 2012, the final cost estimate on which the investment decision was made in 2014 was $8.9bn. The estimated cost has since ballooned by another 24% to $11bn (Sasol's current market capitalisation is $18.4bn), partly due to higher-than-expected site and civil costs, increasing contractor and labour costs and an exceptionally wet rainy season. Sasol's executives are confident that there will be no further delays or cost overruns, and the first unit is expected to be operational in the second half of 2018.

Not everyone is convinced, however. "Further cost overruns remain a concern, given the scale of the project and the fact that they're only 50% complete," says one Johannesburg-based analyst who wished to remain anonymous. "If you've ever built a house, you'll know how hard it is to stick to a budget."

A second analyst, from an international investment bank, says questions remain as to how wise it was for Sasol to undertake such a large-scale project, rather than for example adding capacity to produce value-added chemicals from its existing cracker at Lake Charles.

"The thing with Sasol is – they are the smartest guys in the room. Are they trying to overcomplicate things, or maybe trying to do too much?"

Key risks

For analysts and investors, the concern is the expected returns shareholders will earn from the project. With the latest cost increase, the expected return still beats Sasol's weighted average cost of capital of 8% in the US, but is below its target for new investments of 10.4% returns in dollar terms.

SASOL'S HISTORY IN THE US

1997
Sasol enters US with Merisol JV.

2001
International CONDEA Vista Chemical acquired (incl. Lake Charles).

2003
Sasol lists on the New York Stock Exchange.

2012
Sasol announces world-scale ethane cracker in Louisiana.

2013
Sasol acquires 100% of Merisol JV.

2014
Construction begins on Lake Charles Chemicals Project.

With the latest cost increase, the expected return still beats Sasol's weighted average cost of capital of

8%

in the US, but is below its target for new investments of

10.4%

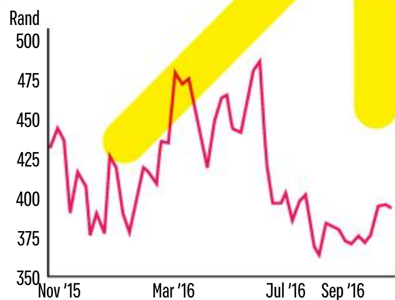
returns in dollar terms.

Aerial view of the LCCP project site from Houston River Road

52-week range:	R354 - R497.47
Price/earnings ratio:	9.52
1-year total return:	-3.73%
Market capitalisation:	R256.62bn
Earnings per share:	R41.40
Dividend yield:	3.76%
Average volume over 30 days:	1 689 968

SOURCE: INET BFA

SASOL



OUTLOOK FOR OIL PRICES

Sasol's fortunes are closely tied to oil prices, as well as the rand/dollar exchange rate. While oil prices have recovered from the lows of $28.80 a barrel seen in January, the current price level of just above $50 remains a long way from the highs of $122 a barrel seen in 2012, when Sasol first announced its intentions to build an ethane cracker and gas-to-liquids plant in the US.

While a draft agreement in September by the Organization of Petroleum Exporting Countries (Opec) to curb supply has pushed prices to above $50 a barrel, Franklin Templeton Investments said in a recent note that any significant further rally would require "a far more vibrant global economy". This seems unlikely, with the International Monetary Fund (IMF) forecasting global growth of a "subpar" 3.1% this year, partly due to a slowdown in the US and the UK's vote in favour of leaving the EU. Global growth is expected to accelerate somewhat to 3.4% next year, according to the IMF.

Steve Cornell, Sasol joint CEO, says Sasol is "optimistic" that Opec may come to "some resolution" on supply. Opec's aim is to reach a final agreement on production cuts in November. "If you look at the fundamentals of the Opec countries and their need to balance their fiscus, the pressure's got to be very high within Opec to find a solution that's different from where we are today."

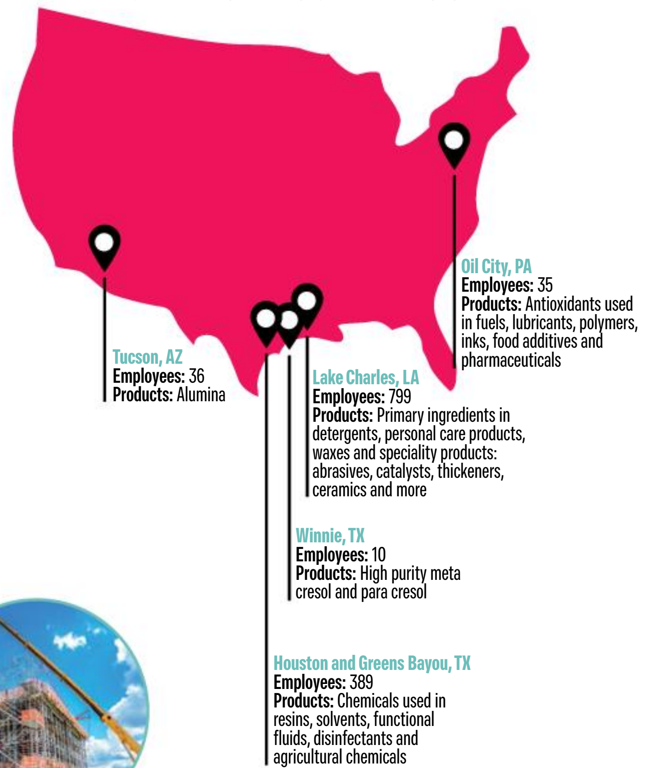
From the perspective of future GTL investments by Sasol, Cornell says it will have to be "something where you are comfortable that long-term will have a good financial return" in a sub-$70 crude world. "Two years ago, we were thinking as long as you can beneficiate at $85 or $90 crude, you're in good shape. Well, we have a different view of the world today, as does everybody," Cornell explains.

The consensus view from the recent annual Oil & Money conference in London was that the world should get used to oil prices between $50 and $60 a barrel as any supply cuts by Opec would be offset by rising shale oil production in the US, where falling costs mean it is viable to develop low-cost resources at these price levels, Bloomberg reported. ■

Images supplied

SASOL'S HISTORY IN THE US

By 2020, Sasol expects to employ more than 2 000 people in the US.



Ethylene oxide (EO) reactor foundation

First equipment being set (acetylene reactors in Cracker area)

Cracker area aerial view

The estimated returns, of course, depend on a number of factors, including the final cost of the project, the cost of feedstock, and the prices it can command for its products once supply comes online. While the US is sitting with a glut of natural gas and natural gas liquids at the moment, leading to depressed prices, Sasol has not been the only chemicals company to spot the opportunity to benefit from cheap feedstock (see sidebar).

"As projects ramp up, the excess natural gas will disappear and things will normalise," the second analyst says.

Sasol has made provision for this in its financial models, saying it expects ethane demand to increase significantly in the next five years due to increased domestic demand and exports. Initially it also expects a glut of ethylene in the US market from the 2019 to 2021 financial years, which will weigh on prices from the 2019 to 2022 financial years. Polyethylene, another product and key input in the production of plastics, is also expected to be in oversupply in the short term, though prices are expected to rebound by 2020, it said.

Sasol sees its competitive advantage on the performance chemicals side, where it will produce a much wider range of specialty

Storage tanks

products than its competitors – in part thanks to its unique Ziegler and Guerbet alcohol technologies – and where it believes it can command higher margins.

But this market is "quite opaque", making it very difficult to do price estimates, the first analyst says. "We won't know [how accurate Sasol's predictions are] until we get there."

Milking the cash cow

As Sasol has taken on some $4bn of debt to fund the LCCP, analysts will also keep a close eye on production levels at its main cash cow – its Synfuels operations in Secunda, which recorded record production volumes in the year to end June – and the rand oil price. A substantial deterioration in either, which seems unlikely at the moment, could lead the group to breach its debt covenants, or force cuts in the dividend.

"In terms of our plans for Secunda – it's really the heart of our company, and we'll continue to try to find ways to make it as beneficial for all the stakeholders – shareholders, employees, communities, government – as we can," says Steve Cornell, joint CEO of Sasol.

"Secunda is operating very well, but any difficulties there will weigh on the group's financial performance," the second analyst said. "The concern is where are the key skills: are they in SA, looking after Secunda, or are they in the US building Lake Charles?"

Another question is whether Sasol's restructuring – Project Phoenix, which led to substantial job cuts – and cost savings plans to deal with the lower oil price environment, "has cut skills too close to the bone or not", the first analyst says. Cash savings to the end of June total R37.1bn, and Sasol is targeting total sustainable cost savings of R7.9bn from the 2019 financial year.

If the analysts can be believed, it's worth taking the gamble: of eight analysts polled by INET BFA, five rate the stock a buy, one a hold and two a sell. ■

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The writer visited the LCCP as a guest of Sasol.

Cooling water tower and pipe bridge

Exchanger transport

Interconnection pipe rack foundations

Olefin storage spheres

WHY LAKE CHARLES?

With an abundant supply of natural gas and natural gas liquids (NGLs), thanks to the shale gas boom in North America, the US has become an extremely attractive destination for chemicals companies.

The American Chemistry Council (ACC) estimated in April that chemical industry investment linked to natural gas and NGLs from shale formations in the US has reached $164bn, with nearly half of the 264 planned projects already completed or underway. The projects include new facilities, expansions and factory re-starts. This is up from about 100 projects with a total potential investment requirement of $71.7bn in 2013. (By comparison, foreign direct investment into the entire African continent only reached $54.1bn last year, according to Unctad data.)

In the Gulf Coast area, where Sasol is building its new chemicals plant, nine new crackers are expected to be in operation by 2022, consuming an estimated 670 000 barrels a day of ethane. The expected increased domestic demand for gas, as well as increased exports, is raising concerns among analysts that the impact on prices will mean feedstock won't be as competitively priced in future as Sasol may be bargaining on. Sasol's first unit is expected to be operational in the second half of 2018.

The ACC said at the release of the report that America's gas and NGL supply outlook is robust, and expected to "last for decades", while its pricing environment "is the envy of the world" – contributing to making the US the "most attractive place in the world to make chemicals".

Steve Cornell, Sasol joint CEO, says the company considered a number of possible sites in the area to take advantage of the abundant supply of feedstock. "What appealed to us about this site [in Lake Charles] is that we could more or less expand our existing footprint, and get the synergies from doing that."

Sasol owns an 890-hectare site in Lake Charles, where it already operates a chemical plant, and substantial room is available for further expansion beyond the Lake Charles Chemicals Project (LCCP). This could include a planned gas-to-liquids plant (GTL) in future, though an investment decision on the GTL plant was shelved last year as a decline in oil prices hurt the group's finances and made the project less lucrative.

Other advantages in the Gulf area include the existing infrastructure in the region, including pipelines, railroads and shipping services, as well as an investment-friendly regulatory environment, which includes financial incentives. "We have certainty on the environmental requirements that we must meet – they're very clear and everyone has to meet them, and the certainty of that is a big draw," Cornell says.

Another advantage is the fact that the US doesn't place ownership requirements on projects such as the LCCP, unlike for example the Middle East, where feedstock is abundant and infrastructure is sufficient. "There is no requirement in the US to have a government partner or any other partner. It's your decision as to how you want to go forward. In the Middle East, you're almost guaranteed you'll have a government partner, and that comes along with some challenges," Cornell says. ■

on the money

THIS WEEK:

>> **Entrepreneur:** The art gallery that is challenging industry traditions *p.42*
>> **Management:** How to steer the ship in times of crisis *p.44*

CEO INTERVIEW

By Lloyd Gedye

Brookes on the big Edcon turnaround strategy

Edcon's new CEO, Bernie Brookes, talks about his ambitious plans to pull the floundering group out of the red.

"thanks for not mentioning the cricket or the rugby," said Edcon CEO Bernie Brookes as *finweek* exited his office last week.

For the last half hour, the 57-year-old Australian expat, who took over the Edcon job in July 2015, had been rather frank and honest about Edcon's past failures.

Brookes had also laid out his turnaround strategy for the group in detail.

The week after the Springboks beat Australia in Pretoria, they were humiliated by the All Blacks in Durban. It's clear that coach Allister Coetzee needs to implement his own epic turnaround; we are still waiting for the detailed strategy.

For Coetzee it's a story of a Grahamstown scrumhalf's journey to top rugby coach in the country. For Brookes, a retail veteran, it's a tale of trolley boy to CEO.

Brookes said he started pushing trolleys in the early 1970s.

He is actually a trained schoolteacher, but found the world of education too slow. "I needed more of a challenge," he said.

It is not Brookes' educational background that prepared him for the turnaround job at Edcon, but his 35 years of retail experience.

Bernie Brookes
Edcon CEO

He worked in India and China in retail businesses selling food, electrical and general goods before returning to Australia to take control of Melbourne-based retailer Myer between 2006 and 2015.

But it's his latest task as CEO of Edcon that seems to have delivered the challenge he was looking for.

The turnaround

Brookes said Edcon's financial turnaround took a lot longer than expected because there were a large number of stakeholders. He recalls something like 60 to 80 meetings with creditors over a six-month period.

The key pillar of the turnaround strategy was the announcement of a sizeable reduction in Edcon's debt. It was reduced from R26.7bn to R6bn. (See sidebar.)

"We reduced our interest payments on debt from R4.1bn to half a billion," said Brookes. This is aimed at freeing up cash flow, to invest in the business.

R20bn of the debt has been turned into equity, with Franklin Templeton, one of the world's largest fund managers, becoming Edcon's largest shareholder. Standard Bank, FirstRand, Investec and Barclays Africa all

> The key pillar of the turnaround strategy was the announcement of a sizeable reduction in Edcon's debt. It was reduced from R26.7bn to **R6bn**

Image supplied

received shares too.

The plan is to list the company on the JSE in a few years, once the turnaround has taken hold, so that the new shareholders can exit.

With the turnaround comes a new board. Brookes said the company is busy recruiting now and the new board will be in place by November. He added that it would be predominately a retail board to bring that expertise into the company.

The previous board had been loaded with private equity players and legal experts.

Already there is speculation that the new Edcon chair will be Andrew Jennings, the former managing director of retail at Woolworths in Australia. Jennings also worked as a special advisor to Brookes at Myer in Australia.

Brookes said he is confident that the team he has put in place to lead Edcon through the turnaround has the skills to get the job done.

He said the team is 50% South African and 50% expats. The South African half of the team brings "strong local knowledge", according to Brookes and the expats are "people who have been in a turnaround before".

"It's a complicated business that we want to simplify," said Brookes. "We need to invest in the business."

Andrew Jennings
Former managing director of retail at Woolworths in Australia

"It's a complicated business that we want to simplify," said Brookes. "We need to invest in the business."

Investing in the business

Brookes said that the plan is to increase staff numbers by 7%, which amounts to an extra 2 000 new people, or 20 to 30 new staff members for every store.

He explained that Edcon has been a dictatorial top-down business and this has disenfranchised some smart staff that worked in its stores, with some choosing to move on. "We need to give them greater authority and responsibility," he said. Brookes added that this strategy was a "cornerstone" of the turnaround.

Edcon will also be spending over R1bn upgrading its IT technology.

Brookes singled out the tills, saying they are old and too slow. "These are an outdated system," he said. "It needs to get done."

He also explained that Edcon's distribution and warehouse system is one suited to fruit and vegetables, not clothing.

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7%,

which amounts to an extra 2 000 people, or 20 to 30 new staff members for every store.

In the past, this resulted in the wrong items being sent to the wrong stores in the wrong sizes. An overhaul of the system is obviously also on the to-do list.

Another issue is that Edcon had relied heavily on brokers and agents – basically middlemen who take their own share of the profit – in the past. Edcon has decided to cut them out and negotiate with the manufacturers directly.

Brookes said that of 37 international brands introduced into Edcon stores, only 12 have been successful. The plan is to remove the remaining 25 from the stores and use this space to build Edcon's own private label portfolio.

"These international brands have not spoken to the local market," said Brookes. "Why would you pay R2 500 for imported jeans when you can buy a pair of jeans for R250?"

He promised that Edcon's prices would be more competitive going forward.

Edcon recently completed a roadshow during which it visited manufacturers in South Africa to talk about specifications and quantities the group will be looking for in order to replace imports, explained Brookes.

He said supporting local manufacturers is about supporting people who shop in your own stores. "Plus orders can be delivered quicker as there is no shipping from China."

Selling non-core assets

Edcon's struggle over the last few years has resulted in repeated calls for it to sell off non-core businesses.

Struggling businesses like stationary retailer CNA and homeware store Boardmans have been on the top of that list. But Brookes said there is no plan to sell either business off right now: "They are not performing well, but plans are in place."

Commenting on the call to sell off these businesses, he claimed that it didn't make sense. "It would be like selling a house in disrepair," he said, "as opposed to selling a house that's been done up."

Brookes said that Edcon needed to spend a few years fixing up these businesses before they could be sold. He said that the group had received offers for

woolworthsholdings.co.za | edcon.co.za

THE DEBT CRUNCH

But how did Edcon get into this position in the first place?

In 2007 Boston-based Bain Capital Partners bought into Edcon with an investment of R25bn, the largest private equity deal in South African corporate history at the time.

However, a year later the global economic meltdown occurred, consumer spending dried up and Edcon was saddled with massive debt.

Cash-strapped due to its monthly interest on debt repayments, the company had to stop investing in its Edgars and Jet stores.

This was a drastic decision as Edgars and Jet make up 85% of the group's sales.

Relationships with staff, suppliers and customers soured due to the cash crunch.

Staff turnover was as high as 30%, with many talented staff heading out the door.

At the same time global international retailers were entering the country, including brands like Swedish retailer Hennes & Mauritz and Spanish retailer Zara.

Edcon's market share would drop from a 37% to a 25% share.

Edcon's sales dropped 1.3% to R27.1bn in the last financial year, while earnings before tax, interest and depreciation fell 1.7% to R2.6bn.

CEO Bernie Brookes said that while Edcon's competitors are generating R24 000 to R34 000 in revenue per square metre, the group is only generating R17 000 per square metre.

Brookes summed up this problem simply – Edcon has too many stores that are too big.

He said that the plan is to close 10% of the group's stores over the next three years as their leases expire. This equates to 150 of Edcon's 1 500 stores.

Brookes said he subscribed to the idea that South Africa is over-malled and that he could see the evidence in the cannibalisation between his own stores. He explained that the Edgars in Mall of Africa drew 75% of its volumes from four surrounding stores in Centurion, Midrand, Fourways and Sandton.

"If you look at the number of malls versus the number of people with disposable income, it doesn't make sense," he explained. "There has to be a sorting out." ■

This was a drastic decision as Edgars and Jet make up

85%

of the group's sales.

The first step to a turnaround is admitting the past mistakes and producing a strategy to address the problems.

these businesses, but they have been "fire sale" prices and Edcon had turned them down.

A lot of the products that CNA deals in have gone digital, according to Brookes. "CDs, DVDs, books – they are all easily downloadable now," he explained. "CNA is into too many product categories."

Speaking about Boardmans, he added that the plan was to put more Boardmans pads in Edgars stores. (A pad is a little mini-store within the main store.)

Brookes insisted that if Edcon were to get a good offer for a non-core business it would sell and pointed to the announcement of the sale of the Legit business to private equity firm Metier for R637m. "We were offered a good price," he added.

Succession planning and retirement

On top of all of this, Brookes said another task is to develop someone to take over the reins when he leaves: "This is my last stint, I am looking to retire in a few years' time."

When *finweek* asked what he plans were for retirement, he smiled: "I have four grandkids whom I would love to spend more time with."

At the moment his family commutes between SA and Australia, and Brookes said he is looking forward to a more stable situation once the turnaround at Edcon has been completed.

Plus being able to be an Australian sports fan in Australia, means you don't have to have over-confident South Africans rubbing every loss in your face, despite the lacklustre performances of their teams.

The first step to a turnaround is admitting the past mistakes and producing a strategy to address the problems.

Brookes knows this, he has a plan, now he has to deliver. ■

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By Jana Jacobs

The art of disruption

Eric Botha of Living Artist Emporium is looking to disrupt the art industry. He explains how his unique model is helping talented artists create, showcase and sell their work.

With so many new and diverse ways of artistic expression, the idea behind LAE was about questioning the traditional art gallery model, explains Eric Botha, founder of Living Artist Emporium (LAE).

"LAE is all about following one's own path and pushing the boundaries and breaking the supposed rules of art that are subscribed to us."

The company's fresh approach has seen it become a leading merchant of world-class contemporary African art, with a client base that includes art collectors, interior architects, designers and decorators. LAE has also supplied artwork to new residential and corporate developments, comprising hotels, lodges, clinics and various other institutions.

Where did the idea for LAE come from?

There are a few artists in my family and I saw the challenges emerging artists experience with breaking into the art industry. Without the right support it becomes extremely difficult and a lot of artists give up on their dreams. By providing the necessary resources, we help the artists to focus on creating art, and we have the opportunity to invest in the early stages of their careers.

What motivated you to get it off the ground?

The initial motivation was to look at different ways of changing the standard "gallery" experience, as traditional art galleries can be a bit intimidating and inaccessible. We started with a few very talented artists and the concept evolved naturally.

How does the LAE Platform work?

The primary focus of the LAE Platform is artist development. Partnering with the artists by providing materials, workspaces and other resources enables them to create world-class contemporary art and build their careers. We promote their profiles and artworks through events, associations and curated art exhibitions within the LAE sphere.

How did you get funding to get started?

The business started out small, with a minimum capital requirement, as we encouraged the artists to use the space they had at their disposal as opposed to waiting for the perfect environment. We also sourced and utilised vacant industrial space that was available at a low cost in Doornfontein.

Where do you currently operate? Tell us about your future plans, including your online gallery.

We currently operate from the LAE headquarters (HQ) at Ellis Park Tennis Stadium in New Doornfontein, where the artists' studios are based. We have an exhibition outlet at 1 Fox Street, Johannesburg, and have associations with numerous reputable art galleries and art dealers. Our future plans are to grow the platform nationally to give more emerging artists the opportunity to grow their careers.

What have been the biggest difficulties you've had to overcome?

First, it was to make the business sustainable for the artists and LAE as a whole.

Second, as newcomers in the art industry, gaining the recognition to have access to exhibit in the same environment as the established galleries.

Biggest lesson learnt?

How to position yourself in the market place. There are a few

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1) The LAE Exhibition outlet at 1 Fox Street, Johannesburg.
2) The LAE Platform has kick-started the careers of many new artists.
3) Some of the works by Vincent Osemwegie, one of the LAE artists who is developing a name for himself in the industry.
4) The LAE Gallery at Arts on Main in the Maboneng Precinct in Johannesburg.

well-established galleries that control most of the market and in order to be relevant you have to take a different approach.

How tough is competition in your sector, and what differentiates LAE from other galleries?

The art industry is extremely competitive and you need to build a reputable brand that your clients can trust. We are competing with businesses that have access to a lot of funding, and some have been in existence for more than 100 years. What differentiates us is the PLATFLERY (PLATForm + galLERY) concept LAE designed, which combines all aspects of creating art and artist development, with the end goal of exhibiting and selling art.

How many artists currently operate via LAE?

We have had over 20 artists who utilised the platform successfully, and currently 10 artists are actively working from the LAE HQ studios.

Can you tell us about some of the artists that have been able to kick-start their careers by being part of LAE?

We have artists from all over Africa, including South Africa, Mozambique, Nigeria and Zimbabwe. The core group of artists who are all currently making names for themselves include Vincent Osemwegie, Ayanda Nkosi, Diezel, Vincent Mbeje, Simphiwe Mlangeni, Jemmiro and Conrad Bo. Our most recent upcoming artists to watch are Greatjoy Ndlovu, Andrew Ntshabele, Kealeboga Tlalang, Danisile Njoli, McCloud Simango, Splash Motong and Solomon Omogboye.

> Focus on earning the revenue first and add the cosmetic side of the business later.

What is the best business advice you've ever received?

When you start a new business, the core is the revenue that is earned to make it sustainable. With limited resources, focus on earning the revenue first and add to the cosmetic side of the business later. There are many great ideas out there, but the implementation is the challenge.

How do you stay motivated?

Enjoy what you do and have a plan and goals. The satisfaction of achieving certain milestones on your journey will keep you motivated to achieve more success.

What is your three-year goal for LAE?

To build associations internationally in Europe and Australia, with the US, India and other parts of Asia to follow in the future. ■

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By *finweek* team

Managing in event of fire

Even in the best of times, leading a team is challenging. When times are tough and the company is distressed, you need an extra set of tools.

Spare a thought for the poor South African manager.

In companies that are often facing extreme economic distress, they are having to lead people and grow businesses while also dealing with a breathtaking range of uncertainties on almost all fronts. Managers in the public sector have it even tougher, as unprecedented levels of politicking have made pawns out of many organisations. Uncertainty and tensions have disrupted at even that most steadfast of entities, Sars, while feuds are raging over other public sector enterprises like SAA and the SABC.

Tensions and emotions run high, staff turnover is high, the stakes are high. Everything is high, except morale.

So how do you manage a team when times are tough?

"When there is a level of distress in an organisation, this is sure to be accompanied by chaos. Your job is to create clarity and to reconnect your team with the company's vision," says Bongi Mbanga, a corporate coach and consultant with Self Insights in Johannesburg.

But first you need to manage yourself, she adds. Amid the chaos, you need to provide (or at least, project) a sense of calm and rationality. Carefully monitor your own actions and reactions.

"Self-awareness as a leader is the precondition for helping employees. When a plane is going down, you put your own oxygen mask on before helping fellow passengers," explains Jonathan Hoch, an executive coach at Hoch Partners in Johannesburg.

Being self-aware means keeping your negative emotions in check. Emotions catch on like wildfire, says Hoch. "You don't want to trigger your team."

Abongile, a graphic designer in Cape Town, was working for an online retailer a few years ago when an IT mishap resulted in the details of hundreds of credit cards being accidentally forwarded to outside parties. On hearing the news, her manager put his head in his hands and said: "We are ruined." The crisis blew over, but Abongile left the company soon after. "His reaction and the little faith he had in the resilience of the company made me worry." People will look to you in times of trouble, make sure you are projecting strength and positivity.

Gallo Getty Image/iStockphoto

Bongi Mbanga
Corporate coach and consultant with Self Insights

Often managers feel overwhelmed by the sheer extent of everything that can go wrong, which adds to their stress levels and impairs their performance, says Bongi. "To avoid this, be clear about what you can control and don't focus on the issues that you cannot influence."

Here are other ways to bolster morale:

CREATE A GREAT AND CLEAR CHANGE STORY: There's a reason emergency procedures – in the event of fire, or when a plane goes down – are simple and direct. Grab the oxygen mask, follow the sign. In a crisis, people need clear instructions. Now is not the time for fancy philosophy or complicated metrics. Instead, cut through the hysteria and worry with a strong message, and a simple plan. Drill it into your team members at every opportunity. They should each know exactly what they are supposed to contribute in this plan. Their goals should be clear and they should get feedback often. This will help them feel connected to the company's goals.

SET AND CELEBRATE QUICK WINS: An easy morale booster is to encourage your team members to achieve concrete, but small goals. This could include cutting costs on an unnecessary expense, or any other measure that will bolster the bottom line. Reward these quick wins with some sort of gesture, for example time off, or a gift voucher. Make sure you communicate achievements.

GET RID OF THE BAD APPLES: When times are bad, and job uncertainty is rife, the cubicles won't be filled with little rays of sunshine. Most people will be negative in trying circumstances, but most people – given the right motivation – can be galvanised into action. Most, but not all. Don't tolerate toxic underperformers that will undermine real change.

THROW OUT YOUR OLD INCENTIVE PLANS: Adapt remuneration to the new realities of your company. Make sure that all incentives are aligned with your turnaround plan, by, for example, rewarding employees who cut costs.

> **"Your job is to create clarity and to reconnect your team with the company's vision."**

RESPECT EACH INDIVIDUAL: In times of distress, bad managers treat their team like they should be thankful for their jobs. Instead, making them feel valued will have an enormous impact on their productivity. Spend time with them, and get to know them. "Be empathetic. People have a basic need to be heard," says Hoch. Seek the opinions of your team members. If they feel that their thoughts are valued, this will create a strong connection to the company.

"Don't let stress distract you from really hearing what your employees are saying. You need to know."

BE TRANSPARENT: Spell out exactly what is happening in the organisation. "People fear the unknown and they crave certainty," says Hoch. Silence breeds rumours and uncertainty. It is absolutely critical that you appear honest and transparent.

OWN MISTAKES: Whatever you do, don't blame anyone or anything for something that went wrong. This will come across as dishonest, and also shifts the locus of control to another party. By admitting a mistake, you also assume control.

PLAN FOR MORE MISTAKES: You may think the four horsemen of the apocalypse have already arrived in the company car park, but there's always something else lurking around the corner. Have contingency plans in place in case of further crisis. Planning will you help feel in control of the situation.

DO THE GEMBA WALK: *Gemba* is a Japanese term meaning "the real place", the place where the work gets done. The "Gemba walk" is management jargon for managers who spend enough time on the front line (for example, at the client call centre) to thoroughly understand all challenges. Don't stay stuck in meeting rooms and your office. Make sure you are walking around and getting a feel for what is happening on the ground.

Empower autonomy. Resist the urge to become dictatorial in order to get things done, says Hoch. "People work best when they feel they are in control of their work." ■

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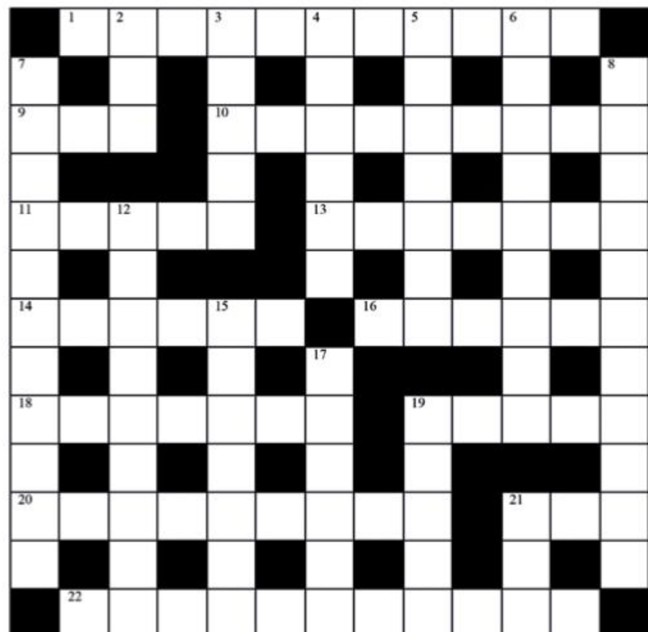
You could stand a chance to win a *Freakonomics* DVD if you get all the answers right in this week's quiz. Enter by completing the online version of this quiz, which will be available on fin24.com/finweek from 24 October.

1. In which country is the city of Mosul located?
2. Who is the Orlando Pirates coach?
   - Pitso Mosimane
   - Muhsin Ertuğral
   - Russel Domingo
3. True or false? Dis-Chem has announced that it will list on the JSE.
4. Jailed #FeesMustFall leader Mcebo Dlamini was the SRC president of a certain university. Name this institution.
5. Who is the CEO of Naspers?
6. What is to be launched by the taxi industry in Gauteng next year?
   - A standardised fare
   - Designated lanes for minibus taxis
   - A cashless fare system
7. Of which country was the late Samora Machel president?
8. True or false? Thailand has a royal family.
9. True or false? Impala Platinum (Implats) is on the JSE Top40.
10. Name the musician who recently won a Nobel Prize for literature.

CRYPTIC CROSSWORD 654JD

ACROSS
1 Doesn't forget what home carer does (5,2,4)
9 Omissions excepted, starting with Royal deer (3)
10 Like a story a lot about first dance movement (9)
11 Not having a brother or sister, goes back by ox (5)
13 *"Cherchez la femme"*, according to Alexandre Dumas – there's always a woman involved (7)
14 Call for space to dock (6)
16 Black African (6)
18 Colouring a police cutter, we hear (4,3)
19 Very chill in general (5)
20 Italian business flair makes for perfect present (5,4)
21 Multiply by 40 for acre or take away 100 (3)
22 Boyfriend manages to sort out the spare tyre (4,7)

DOWN
2 Crack platoon's out of position (3)
3 Con the French painter to come back at noon (5)
4 Went in last thirty and made a score (6)
5 Edits radio band broadcast to north central US (7)
6 Idle gossip coming from teetotal grannie (9)
7 Transplanting a pot climber can be tricky (11)
8 We hear of change to works of art in church (10)
12 Scooter if test-driven features reversing light (3,4,2)
15 Revel in baby (7)
17 Regent in acting arrangement for the Queen (6)
19 Made one's mark with ridiculous ban on Germany (5)
21 Real sort of upset reported (3)



Solution to Crossword NO 653JD

ACROSS: 1 Gash; 3 Egyptian; 9 Inexact; 10 Bombs; 11 Academicians; 13 Charon; 15 Astern; 17 Chrematistic; 20 Pieta; 21 Epicene; 22 Overseas; 23 News

DOWN: 1 Guidance; 2 Stela; 4 Gothic; 5 Public spirit; 6 Immense; 7 Nest; 8 Cape molerats; 12 Unscrews; 14 Achieve; 16 Camera; 18 There; 19 Upgo

On margin

At the Pearly Gates

St Peter is waiting at the gates of heaven and calls the first man in the queue up.

Peter says: "You never cheated on your wife! I'm going to let you drive around heaven in a Ferrari!"

So the man gets in the car and drives off through the gates.

Peter then calls the second man up: "Oh no, looks like you cheated on your wife *twice*! You are going to drive around heaven in an Accord!"

The man gets into his car and drives through the gates.

Peter calls the third man up and says: "You cheated on your wife *five* times. You are going to be driving around in a Fiat Uno!"

But when the third man drives through the gates, he sees the guy in the Ferrari has pulled over on the side of the road, crying.

The man asks: "Why are you crying? You got the nicest car out of all of us!"

He replies: "I just saw my wife go by on a skateboard."

In Brief

You can tell Monopoly is an old game...

...because there's a luxury tax and rich people can also go to jail.

Two police officers crash their car into a tree. After a few moments, one of them says: "Wow, that's got to be the fastest we've ever gotten to an accident site!"

New data from the Hubble space telescope shows that the universe has 2tr galaxies, which is 10 times more than previously thought.

The good news is, none of those galaxies are made by Samsung.

SOURCE: *The Tonight Show* starring Jimmy Fallon

A new study estimates that *Pokémon Go* players took over 100bn steps in the last three months.

Unfortunately not one of them was towards a date.

SOURCE: *Late Night with Seth Meyers*

Archaeologists in Egypt have discovered a pair of socks meant to be worn with sandals from 2 000 years ago. Scholars say it's evidence of the first German tourist.

SOURCE: Conan O'Brien

The Kingmaker @RamsByTheHorns
Overheard at Oakbay offices yesterday:
1st guy: Howa you Nazeem?
2nd guy: Sick.
1st: Quit it man. You look fine to me.
2nd guy: I just did.

Peter Sserwanga @solidgame
Bright Side: Aliens would never try to abduct our fearless leader.
He Does Not Do Probes.

Michael Jordaan @MichaelJordaan
Not believable that Guptas and Van Rooyen had tea the night before he was made finance minister. Surely they would've had wine.

Adv Thuli Madonsela @ThuliMadonsela3
I learned as a child that giving a ride to a scorpion does not buy you immunity from its sting, it only buys you time.

Ronnie Apteker @ronnieapteker
Google News will soon have a fact-check feature alongside its search.
Not to be outdone, Bing announced it'll soon be able to search the web.

The New Yorker @NewYorker
@BorowtizReport*: Nation fears drug test would reveal Trump not on drugs.

Natasha Joseph @TashJoeZA
A cold caller just rang the home line and asked my mum, "Can I speak to one of the computers?"

*Satire

"The market may be bad, but I slept like a baby last night. I woke up every hour and cried."

– Anonymous

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