INSIDE THE BIG BEE

More than 25 years after the first big empowerment deals were done in SA, the collective value of black-controlled entities on the JSE is just over 2% of the bourse's roughly R20-trillion market cap. While there are plans to turn things around, unlisted BEE investment outfits seem less than enthused

Marc Hasenfuss

Is a fixation with maintaining black ownership inadvertently stifling efforts to broaden — and grow — empowerment participation on the JSE?Sizwe Mncwango, for one, believes "true empowerment" on the bourse has either stalled or gone backwards in recent years — "with one of the main causes being a boom in the "tenderpreneurship quick-fix".

Mncwango is CEO of Thebe Investments, probably SA's oldest empowerment firm, founded in 1992 with just R100,000 in seed capital.

Sizwe Mncwango:

"Show me large multibillion[-rand] enterprises that are run, operated, managed and controlled by black people," he challenges the FM.

At the same time, he bemoans the price of vendor financing at punitive coupon rates. "Often business growth is promised, but not delivered, and dividends are not sufficient to service debt, while empowered companies still benefit from BEE credentials at the expense of blackness," he says.

Empowerment activity on the JSE has been relatively quiet in the past five years, compared with the frantic corporate activity that took place between 1995 and 2000, when BEE dealmaking topped R100bn in value.

Some of those pioneering and large empowerment ventures — most notably New Africa Investments Ltd, Real Africa Holdings and later Mvelaphanda — were disappointingly short-lived. And though certain individuals cashed in handsomely, these deals didn't create a vast class of black investors.

That said, there has been enduring empowerment. Unlisted Thebe Investments is still going, and boasts an investment portfolio worth more than R11bn. Hosken Consolidated Investments (HCI), founded in the late 1990s by trade unionists Johnny Copelyn and Marcel Golding with a sliver of a stake in fledgling cellular services company Vodacom, now holds a sprawling portfolio with a market value of R13bn — including ushering start-up ventures such as e.tv (now eMedia Holdings) to sustainable profitability. And Cape-based contenders African Equity Empowerment Investments, Grand Parade Investments (GPI) and Brimstone Investment Corp are still grinding on.

The truth, though, is that hopes of establishing a broad-based national savings vehicle — as the Afrikaners did in the 1940s, 1950s and 1960s with companies including Rembrandt, Sankorp and Federale Volksbeleggings — have all but diminished.

A bare listings landscape

More than 25 years after the first empowerment schemes in SA were hatched, there is but a smattering of

black-owned or -influenced ventures on the JSE.

The biggest is coal miner Exxaro, with a market cap of R70bn, but Patrice Motsepe's African Rainbow Minerals (market cap: R47bn) and Royal Bafokeng Platinum (R40bn) are also easily visible on the listings landscape. These are sizeable black-controlled ventures — but even combined, the three commodity players don't match half the market value of Anglo American Platinum.

Large companies including Telkom, Oceana, Tsogo Sun Hotels and Sea Harvest could reasonably be considered black-controlled entities. Then there are two sizeable investment companies: HCI and African Rainbow Capital.

The rest fall firmly into the small-cap space — though these include well-known shares such as Afrocentric, eMedia, Premier Fishing, Etion, Merafe, Grand Parade Investments (GPI), Rex Trueform, Brimstone and Salungano (formerly Wescoal), as well as company-specific empowerment schemes such as MTN's YeboYethu.

What it means:
A paucity of funding, cumbersome debt burdens and an overall fretting about dealmaking in a fragile economic cycle are contributing to sluggish empowerment investing

By the FM's calculation — using all listed companies anchored or influenced by black shareholding, as well as company-specific empowerment schemes (like those of SA Breweries, MTN and Sasol) — the collective value of BEE-controlled entities on the JSE could be R360bn-R400bn. With the JSE's collective market cap at about R20-trillion, empowerment's presence on the bourse is underwhelming at just over 2%.

Even if "global" listings excluding the large mining counters are stripped out — think Naspers/Prosus, Richemont, AB InBev and British American Tobacco — then black-owned counters represent a still dismal 5% or so of the JSE's collective market cap.

To get empowerment listings to 25% of an SA Inc-based JSE on current metrics, there would have to be a roughly 10-fold increase in the collective value of black-owned companies. That would require the biggest unlisted empowerment enterprises to list — and to grow at a quick lick.

Of course, the modest statistic for black companies' presence on the JSE does mask the many significant minority stakes held by the gargantuan Public Investment Corp and Government Employees Pension Fund, which are effectively the largest asset managers in SA and represent the savings of "workers". The Industrial Development Corp similarly pops up as a significant shareholder in numerous listed companies.

Then there are the mostly low-key initiatives being undertaken by the larger unlisted empowerment ventures (see page 24) — Thebe Investments, the Mineworkers Investment Company, Kagiso Tiso Holdings, Phembani, Lebashe Investment Group (which owns the FM) and Masimong Holdings.

Getting a few of these muscular empowerment contenders to market could be a huge boost for empowerment aspirations, perhaps inspiring others to leverage the advantages that come with BEE investing to create start-up operational and investment ventures.

Thankfully, the JSE is being proactive and has proposed repositioning its BEE segment by undertaking a project to simplify its empowerment listings requirements to ensure a more fit-for-purpose framework.

It will also allow BEE operational companies to list on a standalone basis, where trading will only be allowed between eligible participants. And a

new emphasis on special-purpose acquisition vehicles could also spur empowerment initiatives, allowing companies sufficient leeway to acquire assets from capital raised.

Some empowerment figures canvassed by the FM also suggest that institutional investment firms could be offered incentives to invest in empowerment ventures, and tax-friendly investment structures could be set up to fund BEE ventures (along the lines of the erstwhile 12J initiative).

Steering clear

While it's early days for resuscitating empowerment interest, the FM didn't discern too much enthusiasm for listing when it spoke to a number of unlisted empowerment investment enterprises. None seems overly keen to rush to the JSE — especially not with the market's overall disdain for diversified investment companies that are now lumbered with large discounts to underlying value.

Kagiso Tiso Holdings CEO Paballo Makosholo says black investment holding companies (holdcos) would like to raise capital through various forms — with listing as one of the available options.

"But this alternative would have to be considered in light of investors' preference and valuations attributable to such structures," he tells the FM. "Listed holdcos are currently trading at a discount to their intrinsic value, so it is difficult to see a listing as a viable option which can enhance value for stakeholders."

He notes that while listing is not in his company's current strategic outlook, a JSE listing will continue to be considered as an option — either for the holding group, or its underlying assets.

Lebashe CIO Warren Wheatley probably speaks for a good number of unlisted empowerment ventures when he says: "We prefer to operate without the spotlight on us." And, like other larger unlisted BEE entities, Lebashe has no need to raise capital in the short to medium term.

Masimong Holdings founder Mike Teke acknowledges the need to embrace a broader-based structure to involve more black investors. But for now, he's not weighing up a JSE listing. "Masimong needs an entrepreneurial energy. We have created a platform of beautiful assets, and I would like the CEO to run the business aggressively without any demands for us to take money off the table."

In the longer term, however, Teke recognises that Masimong could have a role to play in morphing into a more inclusive investment vehicle — a proverbial coffer for the nation's savings. "We will build Masimong for the long haul ... and this does mean moving away from the business model of a one-man show," he says.

Others have tried the listings route, without success. Thebe, for example, tried listing in 2018, and learnt some hard lessons during the investor roadshows, says Mncwango.

"A few potential investors were downright and overtly hostile, a significant number of them were demanding exorbitant and/or unreasonable discounts," he says. "What it actually meant, in a nutshell, was a company built over 26 years at that time as a true and pioneering BEE outfit was now going to facilitate non-BEEs to be part of [its] shareholders. BEE partners require facilitation and not the other way round. That is then what I would call empowerment."

Mohsin Tajbhai: The dealmaking parameters of BEE need to be considered holistically

Still, Mncwango says, Thebe will consider listing in the future.

"The benefits of accessing growth capital are quite compelling for a company with our ambitions and a strong pipeline. The current model, though, requires stringent and deliberate reviews to ensure that listing is equitable and value-accretive to black companies beyond just access to capital."

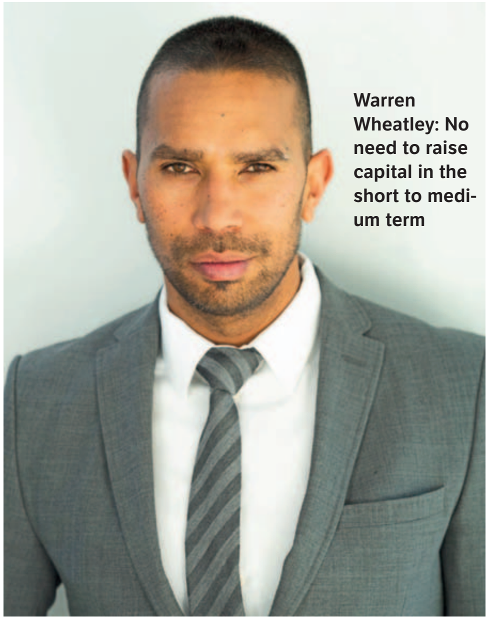
Adherence overkill

While there was an almost obscene ability to create quick value in the early days of empowerment, today it looks like a long, slow haul to riches. That's largely the result of a paucity of funding, cumbersome debt burdens and an overall fretting about dealmaking in a fragile economic cycle.

Indeed, it might be the increased complexities in dealmaking that is mostly keeping empowerment contenders shy of the JSE and the intense public scrutiny that listing brings.

The predicament was well illustrated at the recent Brimstone AGM, where executive chair Fred Robertson faced a pointed ques-

Paballo Makosholo: Listing is just one option to raise capital



Warren Wheatley: No need to raise capital in the short to medium term

tion around a material risk stemming from the fact that the enduring empowerment group is severely limited in its ability to fund transactions.

Brimstone, which still carries a chunk of debt, trades at a 40%-plus discount to the intrinsic value of its portfolio — which effectively precludes the group mobilising scrip as a means of funding potential opportunities.

Robertson responded: "While I firmly believe in broad-based BEE, it begs the question of how long a company — that has been in existence for over 25 years — should be captive to its own investments?

"This is something that needs to be dealt with by the BEE commission."

Robertson's comments reflect Brimstone's lack of flexibility in unlocking further value from its portfolio. With its two largest investments in the fishing sector — a controlling stake in Sea Harvest and an anchor shareholding in Oceana — Brimstone would only be permitted to sell one or both these investments to another equally empowered entity.

That seriously limits the pool of potential buyers. (See *Market Watch*, on page 52, for more on Premier Fishing's predicament.)

According to Robertson, "false markets" are being created by the limitations on potential buyers for Brimstone's assets, while long empowerment "lock-ins" also reduce dealmaking flexibility and, ultimately, efficient value-unlocking exercises.

"The [BEE] market is skewed ... it limits what we can do with our assets. It also limits what our shareholders in Brimstone can do, and how long they should remain invested in the group," he said. "But it's not only us ... BEE restrictions will have a cascading effect through the economy."

One of the more startling examples of BEE adherence overkill was seen in the recent sale of the Burger King SA franchise by GPI. The investment company, like Brimstone, is a long-standing BEE vehicle with extensive community investor participation.

GPI's sale of Burger King would not normally have caused a stir with competition authorities. Yet the Competition Commission blocked the deal on the grounds that the shareholding of historically disadvantaged people (HDPs) in Burger King would shift from more than 68% to zero if the brand was acquired by private equity firm ECP Africa.

Officially there were no employment concerns, as the parties involved gave an unequivocal undertaking that there would be no retrenchments. The transaction also didn't raise any competition concerns.

The deal was significant for GPI shareholders in terms of value unlocking, representing more than 100c a share. It would also be critical in culling GPI's debt to a level where sustainable dividends could flow from its gaming investments (see page 24). Burger King would be able to expand faster (and create jobs) with the help of a new, wealthy equity partner.

On paper, it was a win-win transaction.

But when the Competition Tribunal eventually passed the deal, ECP Africa had to commit to an investment of R500m-plus in capital expenditure, increase staff numbers and salary packages by R120m, and make commitments to local suppliers. It had to create an employee ownership scheme that gave workers a roughly 5% stake in Burger King, and sell off the meat plant that supplied its hamburger patties.

Thankfully ECP Africa had an appetite for growing Burger King, and a strong stomach to swallow the demanding conditions of the deal. Other buyers might have been less impressed, which would have left GPI and its shareholders in a right royal pinch.

In a recent edition of *Dealmakers*, legal experts Daryl Dingley and Elisha Bhugwandeen of Webber Wentzel write that subsequent to the amendment of the Competition Act to broaden ownership provisions, the Competition Commission has approved many mergers subject to conditions aimed at promoting the ownership levels of HDPs and workers.

"Overall, the commission's approach to the application of this section has been in line with its reasoning in the Burger King prohibition," Dingly and Bhugwandeen write.

As a result, they recommend that parties involved in local transactions adopt a proactive approach, and make realistic assessments of what type of commitments may be required if potential public interest issues are anticipated — especially those involving a reduction in HDP/BBBEE ownership levels.

While this is prudent advice, it adds a significant layer of cost and complexity to BEE dealmaking.

GPI CEO Mohsin Tajbhai reckons the dealmaking parameters of BEE need to be considered holistically. "If you are limited to selling only to other black investors, then it effectively reduces the value of black-owned businesses," he tells the FM. "Your investment thesis is to create and unlock value ... and for that you need an (unhindered) exit."

Tajbhai stresses that GPI created substantial value in expanding the Burger King chain and building the brand among fast-food consumers. "We had geared up over five years, and the ECP offer was significantly higher than any other offer we received," he says.

But the competition hurdles were still damaging, resulting in a significant opportunity cost, he adds. The biggest sacrifice was timing.

"With the deal held up we still had to fund Burger King," he says. "These obligations did not go away. We had to keep rolling out stores and keep up with maintenance." **x**

Fred Robertson: Long empowerment 'lock-ins' reduce dealmaking flexibility
Sunday Times / Anton Scholtz