



# MARKET VIEWS

Franklin Templeton Investments

## **South Africa – 2008**

The flight from Dubai to Johannesburg took us seven hours down across the Gulf of Aden over Addis Ababa, Nairobi and Mogadishu. First stop: Johannesburg where most of the large company offices are located. Things are not going so well on the South African political and economic front. The stock market is down, inflation is up and the currency is weakening after having strengthened against the US Dollar. Inflation has jumped to more than 10%, above the target range of between 3% and 6%, influenced by rises in petrol and food prices. As a result of the rising inflation, the Central Bank has been raising interest rates. One of the reasons for the higher inflation is the flood of people crossing the border from Zimbabwe to stock up on goods no longer available in crisis-hit Zimbabwe.

At Tiger Brands, one of the leading branded food company in the country, executives said that their profit margins were being squeezed but they were wary of increasing prices for fear of losing market share. Consumers have been moving down from luxury foods to more basic items.

The country is suffering from electricity shortages as well. Eskom, the state-owned power utility, is asking for a 53% tariff increase to fund a multibillion Rand program to upgrade its infrastructure and add more capacity. They have since been allowed to raise rates by a total of 27.5% for the year by the regulator. The additional inflows of immigrants from neighboring countries such as Zimbabwe has created tension with locals also seeking jobs and resulted in the recent riots.

South African tastes of culture, religions and entertainment reflect the multi-cultural and multi-racial nature of the society. Politics in South Africa, however, is a conundrum. Jacob Zuma defeated President Thabo Mbeki to become head of the African National Congress (ANC), the majority party in the South African government. As Zuma travels the country liaising with constituents across the country, his approval rating goes up while Mbeki's goes down. South Africa's free press is not afraid of pointing out the ANC's corruption. But unfortunately, the ANC tends to protect its corrupt members. The Scorpions, a crime-busting unit, is being closed down and has been described by ANC Secretary-General Gwede Mantashe as a "monster" aimed at destroying leaders linked to the ANC. So the party is now forcing the government to incorporate the Scorpions into the SA Police Services, although the move is condemned by opposition parties and other parts of the society. Mantashe said that the ANC was the "strategic centre of power" and had a duty to ensure that the government lived up to the party's manifesto. The ANC has also opposed proposed Eskom's 53% price hike and accused the company of poor planning which has led to energy crisis.

But not all is negative in South Africa. One of the most attractive aspects is the extension of industries into other parts of Africa. MTN, the cell phone company headed by a black Chief Executive officer, Phuthuma Nhleko, has expanded all over Africa and has more customers in Nigeria than South Africa. Currently, MTN is subject to merger talks with Reliance Communications of India. Black empowerment is a significant theme in the government's programs and every company in South Africa is required to have a scheme which includes training, ownership and executive position for blacks. MTN is one successful example of that transition.

Barloworld is a major agent for heavy Caterpillar equipment not only in Southern Africa but also in Siberia and Spain. Their forklift business extends to Belgium, Holland, the US and the UK. The main challenges are getting trained personnel as well as electric power. For example, motor vehicle repairs suffer when the power goes out. However, because of the electricity shortages, the firm's sales of Caterpillar and Perkins generators are doing very well. One mining company we visited had just ordered US\$75 million worth of generating equipment. But in their car rental business, high interest rates have hit costs and as well as sales. On the motor retail side, interest rates and the new credit act have knocked down sales.

Sasol is a firm with a unique gas to liquid technology. This is know-how gained from Germany's development of converting South Africa's extensive coal reserves to gas and liquid fuel during World War II. The firm has been successfully producing gasoline and diesel for sale in South Africa from the coal-to-liquid technology and is now extending their know-how to Nigeria and Qatar where there are copious quantities of gas available. Qatar probably has the largest reserves of natural gas in the world while Nigeria's gas is currently being flared from oil fields so it is cheap. With the current high oil prices, coal to liquid technology makes a lot of sense. One of the firm's targets is China due to its huge coal reserves.

Standard Bank is another example of a South African company extending its operations globally. Not only does the bank prosper in South Africa but it has operations in Nigeria, Ghana, Tanzania and Kenya. In addition, it purchased Bank Boston's operations in Argentina and has extensive retail operations there. Probably most significant is their alliance with ICBC, China's largest bank. In 2007, ICBC purchased 20% of Standard Bank's capital and started cooperation on facilitating trade between Africa and China as well as jointly started a natural resource fund for investment in Africa.

At Sanlam, the insurance giant, operations are being extended to other parts of Africa at an increasing pace. They are most active in neighboring Botswana but they are also in Kenya, Tanzania, Zambia, Ghana and Namibia with operations just starting in Nigeria. Outside of Africa, they are in India with a 26% share of a joint venture which they expect to extend to 100% once the Indian laws allow it. Instead of sticking to just life and general insurance, they are aggressively moving into the asset management businesses. One executive said: "Difficult stock markets means that customers realize that anyone can make money when stock markets are going up but when things are not so good they entrust their investments to the professionals."

After spending the week in Johannesburg, we visited Cape Town to continue visiting company there. Cape Town is one of my favorite places and probably one of the most beautiful places in the world. Maybe it's the fresh sunshine. Maybe it's Table Top Mountain overlooking the city with the rapidly moving billowing clouds rolling over it.

Maybe it's the unique multicultural society with Malay, White and Black cultural influences. Yes, Malay. When the Dutch ruled this part of Africa they took Malay workers from their Indonesian colonies. Their gentle descendants represent an important community here.

Cape Town's contrasts are incredible and somewhat disturbing but not unlike what we find in other cities. Once you depart the modern Cape Town airport, almost the first things you see are ramshackle squatter towns with shacks made of old cardboard and corrugated iron with a few cinder block walled houses. Then you enter the city on a modern highway and check into your hotel which matches anything you can find in Hong Kong, Singapore or Tokyo, with service to match by polite black and white staff. It's really a pleasure to be sitting in the sauna on the 19th floor of the Westin Grand Hotel with its floor to ceiling windows over looking the splendid harbor and swimming in the indoor pool with a view of the city and finishing it off in the whirlpool with still another view.

The contrast became even more evident when I drove out to Clifton the super wealthy neighborhood of high-end ultramodern houses perched on the cliff overlooking the sea. I always head for the Clifton beaches situated at the bottom of the cliff falling off the oceanside road. The wind in Cape Town can be strong so the protected beach at the bottom of the cliffs are ideal with their pure white sands but super freezing Antarctic water. Sunbathing and playing on the beach are predominantly white, blond, blue-eyed, thin and fashionable South Africans who look and dress like something out of a Ralph Lauren advertisement. But there are also equally beautiful and handsome blacks enjoying the sea and sand.

Before arriving, we read about the violence against immigrants from countries in other parts of Africa. It was when I was eating at one of the hippy restaurants in downtown Cape Town that I noticed the waiter's unusual accent. I asked him where he was from: Zimbabwe. Another waiter: Congo. Another: Botswana. So South Africa and particularly Cape Town has attracted young people looking for work from all over Africa.

My favorite spot for dining and shopping is the Victoria and Alfred Waterfront where you can shop till you drop and where there is always something going on from outdoor pop concerts to black native drummer groups. My favorite restaurant is the Den Anker. The ambience and menu is Belgian but it is in a spectacular setting right on the quayside where the Atlantic Ocean seals play near the pier or bask in the sun and sea gulls swoop. The wall-to-wall windows give a picture-postcard view of Table Top Mountain. They have great Belgian "white" beer and the most delicious selection of oysters and other seafood.

There is also hope of oil off shore from South Africa. I noticed some rigs in the port from my perch in the Sheraton sauna. Cape Town harbor's infrastructure has positioned the city as the natural choice for repair and maintenance. Nevertheless, constraints remain, including delays in the signing of a lease between the National Ports Authority and MAN Ferrostaal for the upgrading of the A-berth, according to Steve Hrabar, the chairman of the SA Oil and Gas Alliance. Another key limitation is skills development, according to independent energy adviser Jack Holliday. "It's a catch-22," said Holliday. "You can't get work without the skills, and you need work in order to get the skills. "That's why we need a step-by-step approach." In Cape Town, the four drilling rigs for maintenance and repairs included: PetroSA's Orca production platform, which is undergoing major

modifications to its legs and buoyancy tanks; Franco-American group Pride's South Seas rig; the Atlantic Venture rig, in for maintenance and awaiting a decision on conversion; and the Ship Shape drilling vessel.

With all its challenges, South Africa is still a great place to visit. I look forward to returning as soon as possible.

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