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Corporate M&A 2022

South Africa: Trends & Developments

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Trends and Developments

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Introduction

Mergers and acquisition activity intensified in South Africa in 2021, after the worst of the disruptions associated with the COVID-19 pandemic appeared to be over.

In South Africa, as elsewhere in the world, COVID-19 has resulted in a spike in takeovers over the past couple of years. COVID-19 has contributed to this trend directly because some companies have been impacted by lockdowns and become cheaper targets, and indirectly because of the availability of funds to potential acquirers, partly due to central banks providing liquidity and keeping interest rates low. This spike in takeovers has been a major contributor to the relatively large number of de-listings from the Johannesburg Stock Exchange (JSE), South Africa's largest stock exchange.

According to research conducted by RMB Corporate Finance, more than 430 M&A transactions took place in South Africa in 2021. One of the most noteworthy features of this activity is that about 70 of these deals, valued at about ZAR750 billion, involved foreign buyers. These included some substantial public and private transactions such as Heineken's offer for Distell, Ardagh's acquisition of Consol, DP World's acquisition of Imperial and Linde's acquisition of 100% of Afrox.

Key trends seen in 2021, which are expected to persist into 2022 and beyond, reflect recent changes to South African competition law and the application of higher environmental, social and governance (ESG) standards. The success of the above-mentioned foreign investment in South Africa indicates an ability to navigate the challenges arising from these changes, particularly the competition authorities' requirement for the introduction of ownership by historically disadvantaged persons [HDPs] and workers in the context of M&A transactions.

The Competition Authorities

Two main trends are evident in the competition authorities' approach to merger approvals: (i) increased concern about public interest considerations in the form of the spread of ownership by HDPs and workers; and (ii) increased scrutiny of digital markets. Mergers adversely affecting the national security interests of South Africa may also be more carefully scrutinised in the future.

Spread of ownership by HDPs and workers

In 2019, the Competition Act was amended to introduce a new requirement that the competition authorities must consider a merger's effect on the "promotion of a greater spread of ownership, in particular to increase the levels of ownership by [HDPs] and workers in firms in the market".

This has been interpreted as requiring a neutral or in some instances even a positive impact on the spread of ownership by HDPs and/or workers. The result was that in 2021 there was a sharp rise in the number of transactions that were approved subject to the condition that the parties introduce HDP/worker ownership.

Merging parties should consider this aspect up front so that they can approach merger negotiations with a plan to introduce or potentially extend HDP/worker ownership, if necessary. This will enable the merging parties to present a proposal to the competition authorities which could avoid delays in obtaining approvals. Merging parties should be aware that, even if a transaction is public interest-neutral in respect of its impact on HDP/worker ownership, they could still be asked to increase HDP/worker ownership or make proposals that would promote a greater spread of HDP/worker ownership.

If parties do not reach agreement on HDP/worker-ownership conditions where necessary, this could cause a significant delay in obtaining competition law approval. This could also cause the Competition Commission to unilaterally impose conditions or in extreme cases, even prohibit the merger.

There is still some uncertainty regarding the interpretation of the HDP/worker-ownership provisions. Given that these provisions are still relatively new in their application, there have been no legal challenges to the authorities' approach that would help to establish precedent. The competition authorities' approach is also still developing on a case-by-case basis. Practitioners are hopeful that, over the next few months and years, there will be a more standard approach as the interpretation of the HDP/worker-ownership requirement crystalises so that merging parties can have more certainty regarding the legal position and the competition authorities' expectations.

National security review
An amendment to the Competition Act, which has yet to take effect, will require the President to set up a committee, comprising cabinet members and other public officials, to determine whether mergers involving foreign acquiring firms may have an adverse effect on the national security interests of South Africa.

The President must also publish a list of national security interests of South Africa, including the markets, industries, goods or services or regions in respect of which mergers involving foreign acquiring firms would require the approval of the committee. It is expected that technology will be one of the sectors that will appear on the list. Although the amendments to the Competition Act will involve an additional review process for foreign direct investment mergers, they do not expand the scope or nature of foreign direct investment mergers to be scrutinised, as the committee will only consider those mergers that meet the thresholds already applicable under the Competition Act. Applications for foreign direct investment approvals will need to be filed at the same time as applications for competition approvals and are likely to follow a similar timeframe (currently the proposed review period for the committee is 60 business days – which is the same as the maximum review period for an intermediate merger).

Increased scrutiny of digital markets
Last year the Competition Commission issued a paper, "Competition in the Digital Economy" setting out its intended strategic actions in relation to competition law issues in the digital economy. Many of these actions seek to revolutionise the way that competition law is applied to digital firms in South Africa. The paper recognises that the digital economy in South Africa cuts across all markets in which an internet base is used for production, distribution, trade and consumption by different agents.

The paper sets out some of the actions the Competition Commission proposes to take to increase competition enforcement in the digital economy. Amongst these proposals is a requirement that small mergers in digital markets, which would otherwise not be notifiable because they fall below the notification thresholds, be notified to the Competition Commission under certain circumstances. The Commission has already published draft guidelines for its approach in this regard. This is partly to address the problem that technological innovations are often owned by start-ups with low turnover and asset values, although the acquisition of one or more small start-ups can have a significant effect on competition and could even create or enhance dominance in a market. The Commission will also look at alternative tools to assess the impact of digital mergers on competition as traditional tools of assessment (eg, market shares) may not be sufficient to identify potential competition effects in markets driven by evolving technology and innovation.

New Moves on Corporate Governance

High pay

Global and local investors have increasingly raised concerns around the excessive remuneration of senior executives. In light of this, the Companies Act Amendment Bill 2021 includes proposals that significantly extend the disclosure obligations relating to such remuneration.

These changes include the requirement for more detailed disclosure, by certain categories of companies, of remuneration paid to directors and prescribed officers, as well as details of the pay gap between directors and workers. This includes the obligation to publish details of the highest and lowest paid employees, their average remuneration, median remuneration, and the gap between the highest paid 5% and lowest paid 5% of employees. These details must be published in financial statements and annual reports.

The Bill also gives shareholders more power to challenge excessive remuneration. The Bill proposes to change the existing advisory vote on the remuneration report to a binding one, and to extend this regime also to the implementation report. It is unclear what the consequence will be if shareholders do not approve the implementation report.

Employee representation on boards

In the longer term, there are plans to amend the Companies Act to give workers the right to appoint directors to the boards of companies, and to extend directors' duties to consider the interests of multiple stakeholders. Both of these issues will be addressed in a future amendment, to allow more time for consultation.

Although the Department of Trade, Industry and Competition is understood to be strongly in favour of these amendments, there is considerable resistance from the corporate sector, since historically the shareholders have appointed the directors and it is to them (the shareholders) that, exceptions aside, the directors owe their duties. In Germany, where workers have representation on the board, there is a two-tier board structure, with one level making policy decisions and a second level making operational decisions. However, South African companies have a unitary board structure.

Having to accommodate a specific board position (and, presumably, vote) will likely present difficulties in the context of a typical private joint venture board, or in circumstances where the parties wish to incorporate a bespoke board structure with specific voting rights or voting balances. The extension of fiduciary duties to include, for example, employees and other stakeholders, would engage new dynamics for a board when considering any number of strategic transactions. These would, for instance, include situations where a board is evaluating a takeover proposal, both of the company and by it, or restructuring the business. Unless legislated clearly and with sufficient flexibility for the board to continue to exercise business judgement in balancing such matters, this additional complexity and risk in decision-making will be factors

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that existing and inbound investors would need to take into account.

Environment, social and governance (ESG) concerns

Although the widespread adoption of ESG principles is still in its early stages in South Africa, it has already become an important feature in M&A activity, especially for inward acquirers. Investors are taking ESG risks into account in the same way that they try to anticipate cyber-risks. Examples of this include a foreign acquiror undertaking a detailed analysis of whether the South African target company was pricing its products fairly to underprivileged clients in the local market, and heightened evaluation of the long-term impact to the target businesses of transforming to meet ESG requirements and norms, or of failing to do so.

There are two reasons for this trend. One is that it is an increasingly irresistible global movement and, secondly, it comes from increasing shareholder, employee and consumer activism. If a company fails to consider all important ESG aspects, it risks reputational damage.

We have already seen significant M&A activity over recent years in the South African oil and gas sectors, and we expect this to continue. Organic drivers aside, this activity will continue to be driven by the global trend of the oil and mining majors diversifying out of petrochemicals and through South Africa's move away from fossil fuels to a different energy mix. South Africa's oil and gas sectors, both upstream and downstream, have traditionally been dominated by the majors, and to a large degree still are. However, many of them have been making moves to hive off their downstream operations, to exit or close their refining assets and, in some instances, to separate their South African operations from their parent group.

Recent examples of this include Anglo American's spin-off of its South African thermal coal into JSE-listed Thungela Resources.

This trend is expected to continue, and is typified by BP and Shell's announcement that they would halt operations at the SAPREF refinery in South Africa indefinitely while they considered options, including a sale.

Areas of Greatest Activity

Some of the sectors seeing most M&A activity are financial services, telecoms and technology in general, and this is expected to continue. With scale and first-mover advantage being significant drivers, much of this activity is in the form of mergers of entities with synergistic strengths or complimentary geographic footprints, or in joint ventures where complimentary business lines operate. While this is of course nothing new, the scale and scope appear to be accelerating. This is driven partly by the size and speed of the growth and adoption of technology in critical aspects of everyday life, but also by the growing attractiveness of the largely untapped African market, both for global investors and for South African companies whose local market often has limited room to grow.

Another sector where activity is strong and likely to continue is in logistics and supply chain control and optimisation. This activity has, of course, been driven by the global supply disruptions that followed COVID-19 lockdowns and the heightened demand by customers for online solutions. However, the immediacy of COVID-19 impacts masks the more significant longer-term strategic trend where logistics, especially those which connect directly to the customer, are increasing seen as a key strategic asset. This is particularly the case for retail and financial services companies.

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In the longer term, there may also be some M&A activity around the restructuring of parastatals. The rescue of South African Airways, in which the Takatso Consortium has purchased 51%, is a typical example. Some of the other state-owned enterprises (SOEs) seem likely to need private sector white knights to both assist the funding of their operations going forward and to restore them to profitability.

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