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South Africa: Trends and Developments

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Trends and Developments

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Recent M&A Activity

Merger and acquisition activity in South Africa in 2022 was 7% lower than the recent peak reached as a result of deals delayed during the lockdowns at the height of the COVID-19 pandemic.

Some of the headline South African M&A transactions in 2022 included:

- the USD4.49 billion takeover by a consortium including Remgro of the Mediclinic International group;
- Bidvest's purchase of Australian cleaning specialists BIC for AUD160 million;
- the Ardagh acquisition of Consol Glass for USD1 billion;
- Walmart's acquisition of the remaining shares in Massmart for ZAR6.4 billion; and
- the Clicks acquisition of the Sorbet group for ZAR105 million in cash.

Broad-Based Black Economic Empowerment (B-BBEE) transactions continue to fuel some of the M&A in South Africa. There was more activity than in recent years in establishing employee share ownership programmes (ESOPs), either on their own or with other partners, to constitute B-BBEE ownership transactions. In the last year, the headline B-BBEE transactions included Shoprite (ZAR8.9 billion), Kumba (ZAR2.5 billion) and Rusternburg Platinum Mines (ZAR8.3 billion).

Other M&A activity (which was not concluded) included the Takatso consortium's long-drawn-out efforts to acquire a 51% stake in state-owned airline SAA; MTN's proposed acquisition of Telkom; and another long-drawn-out M&A battle as Impala Platinum and Northam Platinum made rival bids for Royal Bafokeng Platinum.

Current Trends

Energy sector

Energy was front of mind for many businesses in South Africa in 2022, as a result of load-shedding caused by the state-owned energy monopoly, Eskom, being unable to supply sufficient power. The main focus of investment was on establishing new sources of renewable power generation, following the lifting or easing of regulatory restrictions, rather than M&A activity. However, coal mining companies, in particular, have been investing in already-developed renewable energy portfolios.

There were some modest-sized energy deals, as smaller independent power producers (IPPs)

sought to dispose of already-operational facilities for various reasons, including to raise liquidity to fund other or bigger operations.

Few international acquirers are interested in smaller scale IPPs in South Africa, especially given government delays in procuring new power over the past three to five years under the Renewable Energy Independent Power Producer Programme (REIPPP). There is some uncertainty about whether there will be another REIPPP round. The extended delay in closing the risk mitigation independent power procurement (RMIPP), which was launched in August 2020 and seen by the market as an emergency procurement programme, has reduced confidence in government's renewable energy procurement ambitions. However, the Eskom debt restructuring package, and the progress in unbundling Eskom to, in part, establish a standalone transmission company, announced by the Minister of Finance may result in Eskom being able to support further REIPPP procurement rounds.

In the oil and gas sector, the biggest deal occurred in February 2023, when Petronas announced the sale of its 75% interest in Engen to Vivo Energy. Another subsector attracting interest is the battery sector, across both South Africa and the rest of sub-Saharan Africa.

After the announcement of the Department of Trade, Industry and Competition (DTIC) that it would set up a "one-stop shop", with "unblocking teams" being assembled to speed up the regulatory processes required for investment in new power generation, there may be an increase in activity in this sector.

Litigation on appraisal rights

In recent years, reported Section 164 appraisal rights cases have increased. There have been about eight appraisal rights cases in the last 15 years, but the pace is picking up, with one every year for the past six.

These cases have clarified a number of points. One is that repurchases in excess of the 5% threshold are protected by appraisal rights. Another is that only registered shareholders can use appraisal rights, thus placing greater responsibility on nominee shareholders, who have to exercise appraisal rights (and take on any litigation) for their respective beneficial shareholders. The visible increase in shareholder activism (of which appraisal rights are a part) has resulted in greater activity and additional responsibility for nominee shareholders.

Clarification is still needed on certain matters, however, including the right to waive appraisal rights prior to the event that gives rise to them (this will probably not stand up, but it has not yet been determined by a court).

Although not favoured by the courts, use of appraisal rights to obtain a higher price is not considered an abuse of the courts. Any form of arbitrage – eg, buying the shares and using appraisal rights to obtain a higher price – is, however, seen as an abuse of the courts.

Much of the litigation on appraisal rights has been centred on the concept of fair value. It is clear that the offer price made by the board will set a precedent for the fair value of the shares, although it is not determinative particularly as, in the case of a scheme of arrangement or mandatory offer, there is a lapse of time between a fundamental transaction being announced and the date on which the fair value is determined.

The Competition Commission

In 2022, the Competition Commission (CC) continued to pay heightened attention to public interest factors in merger applications. Transactions are being rigorously interrogated to determine whether they "promote a greater spread of ownership, in particular, to increase the levels of ownership by historically disadvantaged persons (HDPs) and workers in firms in the market, as required by the Competition Amendment Act".

The emerging approach, being applied by the CC increasingly consistently, is that neutrality is not enough. Merger parties are increasingly being requested to make submissions on whether transactions have a positive impact on HDP/worker ownership.

Given the increased focus on public interest, it has become more important for merger parties to consider upfront not only HDP/worker ownership, which is a priority, but also broader public interest concerns. These concerns could potentially be used to offset adverse effects on HDP or worker ownership, or to otherwise justify transactions on public interest grounds as part of a more holistic public interest assessment of transactions. This emphasis is expected to remain.

The DTIC has also been intervening more than previously, by making submissions on the need for parties to put in place employee ownership or share schemes in place. There are indications that the DTIC intends to publish regulations that will guide how merger parties interact with the DTIC to craft public interest conditions.

The CC is currently completing its market inquiry into the online intermediation market and will shortly begin a second inquiry, which will be into the fresh produce market. It is anticipated that other inquiries on aspects of the digital market will follow. These inquiries are significant for M&A since they suggest that transactions in one of these sectors will likely attract increased CC scrutiny.

After introducing its revised small merger guidelines, which came into effect on 1 December 2022, the CC has now expanded its reach on small mergers (which generally do not require mandatory approval as they fall below the prescribed financial thresholds). Under the revised guidelines, parties in certain small mergers are advised to inform the CC of their intention to enter into a transaction, thereby allowing the CC to potentially call for a merger application in respect of small merger transactions, which could otherwise have escaped scrutiny.

The authors of this article suspect the CC may call for mergers in priority sectors to be notified, particularly since the revised small merger guidelines do not only apply to digital markets (as initially proposed) but to any merger where the acquiring firm's turnover (excluding the target) exceeds ZAR6.6 billion, and the consideration for the target is ZAR190 million or more or the consideration values the target at a minimum of ZAR190 million.

Delistings from the JSE

In its latest financial results, the JSE expressed concern that the delistings trend is continuing. In 2021, 25 companies delisted, which dropped to 22 in 2022, and this is not being matched by new listings. There is a similar trend on the London Stock Exchange, although not to the same extent. The JSE recently changed its Listings Requirements in an effort to reduce the regulatory burden on companies and has considered establishing a new technology sector (although there would be limited liquidity in this sector, so

it may not justify the expenditure on the part of the JSE).

A significant regulatory development in 2022 was the JSE's increase in the minimum threshold for shareholder approval of a delisting to 75%. In the case of a delisting by way of scheme of arrangement, this increase in the shareholder approval threshold is not always problematic, given that it is the same as the approval threshold for a scheme of arrangement. However, where delisting would be sought subsequent to an offer to shareholders, the 75% approval threshold may not be met, and the offeror would acquire a majority stake in a company, but not be able to delist the company. A solution may be to include the passing of the delisting resolution as a condition to the offer.

B-BBEE Commission

In recent years, the Broad-Based Black Economic Empowerment (B-BBEE) Commission has been taking an increasingly active role in counteracting what it believes are fronting practices. It has tended towards an extremely restricted interpretation of the B-BBEE legislation. The B-BBEE Commission's restrictive interpretation has flowed through to its assessment of major B-BBEE ownership transactions. It has been scrutinising the terms of transaction documents more and more restrictively, sometimes without making reference to the provisions of the applicable B-BBEE legislation, which underlies the B-BBEE Commission's concerns.

The B-BBEE Commission (and now increasingly B-BBEE verification agents) regard the absence of a dividend payment to shareholders as an indication of a fronting practice as no effective economic benefit is being realised by Black shareholders. The presence of a "trickle dividend" is at times viewed favourably by the B-BBEE Commission and B-BBEE verification agents.

Shareholder activism

Shareholder activism is an evolving trend in South Africa, particularly on corporate governance issues. The most prominent concern over the past year has been executive remuneration packages, which boards have been asked to justify. Increasingly, there is opposition to approving resolutions on remuneration policy.

Institutional shareholders have also raised concerns about transformation, specifically board composition/diversity in terms of both race and gender, as well as over the tenure and lack of independence of board members, and poor attendance at board meetings.

Another growing trend for shareholder activists in the past year has been climate change.

Economic activism, which is aggressively pursued in the USA and somewhat less so in the UK/EU, is not yet common but has shown nascent growth in South Africa. There are a number of investment entities taking stakes in JSE-listed companies considered to be trading below intrinsic value, with the aim of working with the board to unlock value. In one case, the targeted company had to reduce the amount it had planned for its rights issue as a result of pressure from one such shareholder.

Looking Ahead

A number of regulatory changes were enacted towards the end of 2022 in an attempt to stave off South Africa's grey-listing by the Financial Action Task Force (FATF) – unsuccessfully, as the FATF still grey-listed the country in February 2023. The amendments were aimed at combating money laundering and other financial crimes.

A significant development for future M&A is the amendments that have been made to the Companies Act on the disclosure of beneficial shareholdings. It is now a requirement to file beneficial shareholder disclosures with the Companies and Intellectual Property Commission (CIPC) (previously, only the Takeover Regulation Panel (TRP) had to be notified of beneficial shareholdings) and to update the list every time share capital (within a class of shares) changes by 5%.

The implication of South Africa being grey-listed for M&A investment decisions is that it may discourage inward FDI and will likely lead to greater due diligence on targets. There will also be increased regulatory scrutiny, which increases transaction costs and completion risk. On the positive side, greater scrutiny often leads to better governance. Stricter due diligence investigations should bring greater comfort to lenders and parties to a transaction.

South Africa is looking to move out of grey-listing, hopefully following the example of Morocco and Mauritius which were able to get off the list within two years. In the meantime, some European investors may not be allowed to invest in South Africa and others may have to divest, which may stimulate M&A activity in the short term, albeit for the wrong reasons.

As far as the CC is concerned, it is likely there will soon be changes to the merger notification forms. Significantly, these changes will make information gathering more onerous, as parties will have to address all public interest grounds upfront, rather than reactively as many parties have historically opted to do. The new forms will require more work on preparing filings and potentially more detailed assessments of the impact of transactions on competition and public interest.

This could mean longer lead times in preparing filings, and may affect parties' appetite for transactions. It means the parties need to think more carefully about the broader impact of transactions proactively and potentially develop contingency plans and arguments to mitigate against lengthy approval processes and protracted engagements (particularly in large mergers) and potentially onerous public interest conditions.

A development for deal-makers to be aware of is a recent presentation by the TRP in which it sketched out its short and long-term goals. One of these is that it is considering establishing a Surveillance Unit which would increase the TRP's capacity to investigate certain complaints and to monitor companies for a period following their delisting.

Among the TRP's long-term goals are extending its jurisdiction across the Southern African Development Community (SADC), expanding its powers in existing areas of supervision, setting new timeframes for competing offers (the need for which became evident in the Impala Platinum/Northam bids for Royal Bafokeng Platinum) and regulating appraisal rights (the need for which is evident in the increase in litigation on appraisal rights).

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