M&A deals in Africa drop this quarter with South African political uncertainty

The latest quarterly Cross-border M&A Index shows that there were 17 inbound M&A deals in Africa in Q2 of 2017. The 17 inbound deals reflect a 48% drop from 33 deals in Q2 2016. On a quarter-by-quarter basis, inbound deal volume also dropped - by 45% - from 31 deals in Q1 2017.

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The total deal value for inbound deals amounted to $780 million, decreasing by 83% year-on-year and 88% on a quarter-by-quarter basis. The second quarter of 2016 saw $4.54 billion worth of deals. In the first quarter of 2017, $ 6.38 billion worth of inbound deals were concluded in Africa.

Morne van der Merwe, managing partner of Baker McKenzie in Johannesburg explains, “Foreign Direct Investment (FDI) in South Africa has decreased and this will continue until the local investment climate stabilises. Due to the credit ratings downgrades, the cost of raising capital for acquisitions has become more expensive, making deals more difficult. In addition, the Rand has been one of the most volatile currencies in 2017 and this volatility has suppressed deal appetite.

“These factors, combined with recent political instability and uncertainty, have resulted in a perception in the market of increased risks of doing business in South Africa. Global players are finding more attractive investment destinations elsewhere.

“Further, almost half the continent’s M&A activity flows through South Africa, so recent South African developments have had a negative knock-on effect in Africa. Political uncertainty in other jurisdictions on the continent, such as the current election in Kenya, has also made investors wary of African deal making in the short term, although we expect this to change once stability returns to the region.”

The top target industry by volume and value in Africa was mining, which accounted for 23% of total deal count and $312 million or 40% of total value.

Mining sector looks bleak

In terms of outlook for the mining sector in South Africa, van der Merwe says there is widespread agreement that the Mining Charter in its present form will severely affect the mining sector in South Africa. In addition, the recent proposal, published in the South African Government Gazette for comment, regarding a possible moratorium on mining and prospecting rights and the granting of applications in terms of section 11 of the Mineral and Petroleum Resources Development Act is cause for concern. If these measures come into effect, they will have a detrimental impact on transactions in the South African mining space.

No technology deals

Looking at the technology sector, the M&A Index showed no inbound technology deals in Africa in second quarter of 2017. This is in comparison to the global results, which noted a high volume of technology deals in the first half of 2017. Globally, besides H1 2016, the number of cross-border technology deals was higher in H1 2017 than in any post-crisis half-year period.

“Africa has several technology hubs, including one in Cape Town, South Africa and the development of technology in the banking and finance sector, for mass usage on the continent, is well advanced. A positive explanation for there being no inbound deals in this sector in Q2 2017, is that this is not due to lack of IT development in Africa, to the contrary, but because IT companies are structuring their operations in a way that allows them to enter into partnerships offshore and bring their operations into Africa through licencing arrangements.”

South Africa tops in inbound deals

The Index shows that South Africa was the top target country for inbound deals by volume and value, accounting for 29% of total deal count and $422 million or 54% of total value in Africa. The top investing country by volume was Australia with three deals or 18% of total count. China deals had the highest overall value at $324 million or 42% of total.

“It is surprising that Australia was the highest inbound investor country by deal volume as one would expect it to be China or India. Australia is a resource-based economy, with the knowledge, know-how and asset base to attach to opportunities in Africa, so it does make sense that it would be investing heavily in African businesses.”

Asia Pacific and the European Union were tied as top investing regions by volume, each accounting for 35% of total deal count. By value, Asia Pacific outpaced the rest with $487 million or 62% of total.

Outbound deals catching up

Cross-border outbound deals painted a more positive picture. There were 15 cross border outbound deals in Africa for the second quarter of 2017, a decrease of 12% on a year-on-year basis, but an increase of 67% from the previous quarter. The second quarter of 2016 saw 17 outbound deals, while the first quarter of 2017 saw nine outbound deals. The total deal value, $1.52 billion, fell by 28% from $2.1 billion in Q2 2016, but more than doubled on a quarter by quarter basis from $665 million in Q1 2017.

Technology tied with Business Services was a top target industry for Africa's outbound deals by volume with a total of three deals for the quarter (20% of total). In terms of deal value, the Financial Services sector led slightly with $ 535 million or 35% of total deals. Technology deals came in close second, accounting for $510 million or 33% of total outbound deals from Africa.

"Increase in development in African telecoms industries, as well as the opportunities presented by a rapidly developing financial services sector, remain key drivers of outbound investment activity in Africa. The growing financial services sector has also seen domestic banks make significant investments in technology, including in offshore companies. As discussed, the increase in outbound deals in the technology sector also points to African technology companies looking to base their local operations offshore."

The Index also shows that South Africa outperformed other African bidders by volume and value for outbound deals, with eight deals (53% of total) amounting to $821 million (54% of total). Top target regions for outbound deals were EU and Asia Pacific by volume, each with 40% share of total. The top target country from Africa by volume was India, with three deals accounting for 20% of total deal count.

Global M&A outlook

Despite a backdrop of continued political turbulence, cross-border deal making held steady in Q2 2017, driven by deal activity involving the EU, according to Baker McKenzie's Cross-Border M&A Index.

Buyers announced 1,368 cross-border deals worth $345.8 billion, a 10% decrease in volume but only a 1% decrease in value compared to Q1 2017. As the EU gained relative stability in the wake of Brexit developments and elections in the region, it accounted for more than half of cross-border deal value and nearly half of cross-border deal volume in Q2 2017. Baker McKenzie's Cross-Border M&A Index, which tracks quarterly deal activity using a baseline score of 100, decreased to 233 for Q2 2017, down 4% from the prior quarter but up 15% from Q2 2016. In Q2 2017, cross-border M&A made up 36% and 47% of global deal volume and value, respectively.

"We continue to see an increase in deal value as companies are choosing to invest more money in a smaller number of handpicked deals," said Michael DeFranco, global head of M&A at Baker McKenzie. "While deal volume decreased in Q2, we are encouraged by the activity in the EU and the return of China to the deal table. As we head into the second half of 2017, we continue to believe M&A activity will pick up."

The leading bidders for cross-border deals into the EU were the US, China, and UAE, in addition to cross-regional deals from companies in the UK and Italy. Seven of the top ten most targeted countries in Q2 2017 were in the EU, compared to only four in Q1 2017.

For more information, go to crossbordermaindex.bakermckenzie.com.