



One Absa

South African Protein Seminar

Financing Agri-business and Food Processing in Southern Africa

March 2011

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The headlines



The Scary Stories

Manufacturing output decline, industry may cut jobs *Engineering News, March 2008*

Manufacturing confidence slumps to 7½ yr low *Engineering News, June 2008*

Manufacturing output contracts, sales slump *Business Day, May 2008*

June PPI a shock to the system *Mail & Guardian, June 2008*

PPI piles on the pressure *www.fin24.co.za, June 2008*

Higher CPIX may promote another rate hike *Business Report, June 2008*

FTSE-JSE indices	Close	% Chg	BONDS/FORWARDS	Yield	% Chg	CURRENCIES	Rate	% Chg	COMMODITIES	Label	% Chg	FOREIGN MARKETS	Label	% Chg
All share	30 003.76	- 1.35	R153	11.87	1.15	R/£	7.872	- 0.34	Gold PM Fix	937.50	0.78	Dow Jones	11 382.26	0.28
Top 40	28 915.29	- 1.37	R196	12.44	0.97	R/€	15.716	- 0.60	Gold NY	939.97	1.50	S&P 500	1 284.91	0.38
Fixed 30	22 067.22	- 1.63	3-mo NCD Spot	12.43	0.16	R/¥	12.433	- 0.63	Brent Future	140.67	0.60	FTSE-100	5 479.00	- 2.60
Revenue 20	77 700.06	- 1.22	R/¢ (4-mth)	8.218	0.83	\$/¢	1.519	- 0.22	Platinum PM Fix	2 075.00	0.53	Nikkei 225	13 483.20	- 0.80
Golden	2 387.34	- 0.45	R/¢ (12-mth)	8.512	0.78	¥/¢	106.130	- 0.07	Palladium Spot	488.00	1.96	Kuro Dax	8 915.94	- 1.80

Manufacturing sector 'heading for recession'

Risk fears and weak bourses depress JSE

Meeg founder Molefe 'will lay charges against Absa'

SE suspends King trading

HARVEST OF TERROR

OIL: BRENT CRUDE

Daily (\$/barrel)

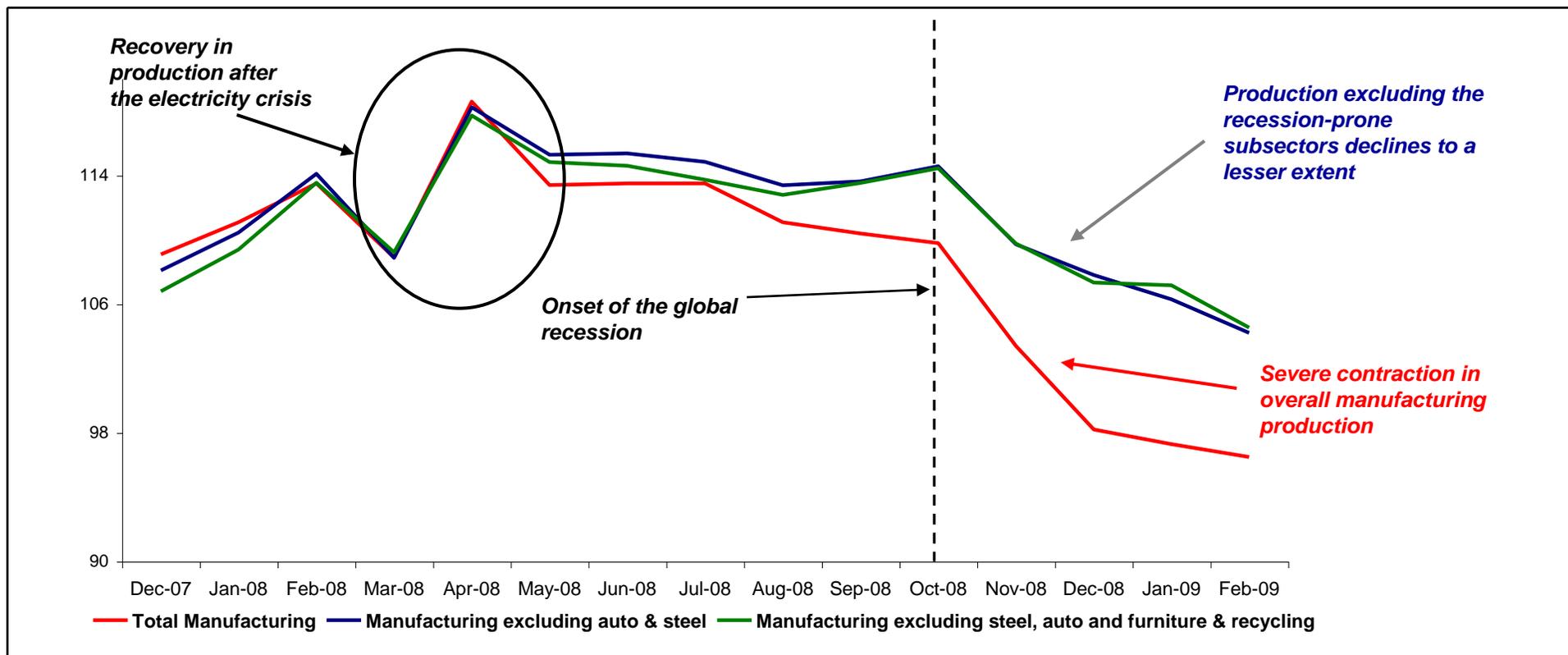
Investor: Asset Management head

dealer: Doug Blatch

Blatch said the

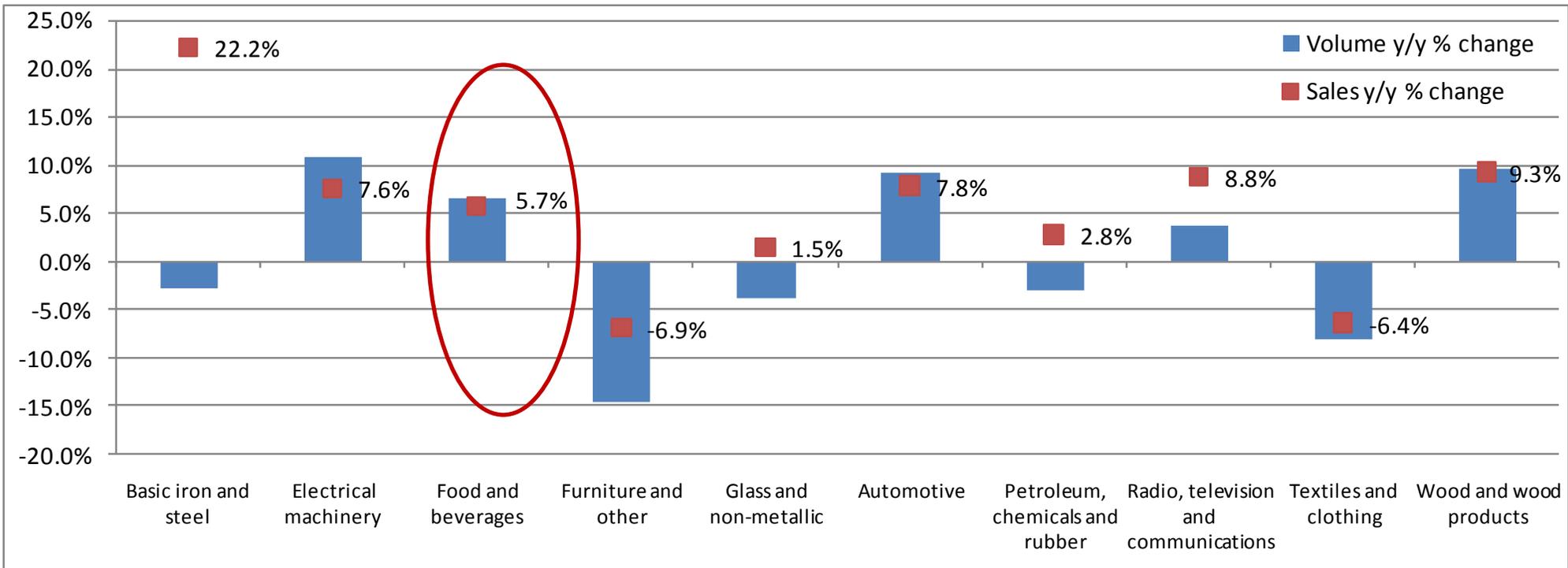
↑ 1.85%

Manufacturing production analysis: Not all sectors effected equally by the recession



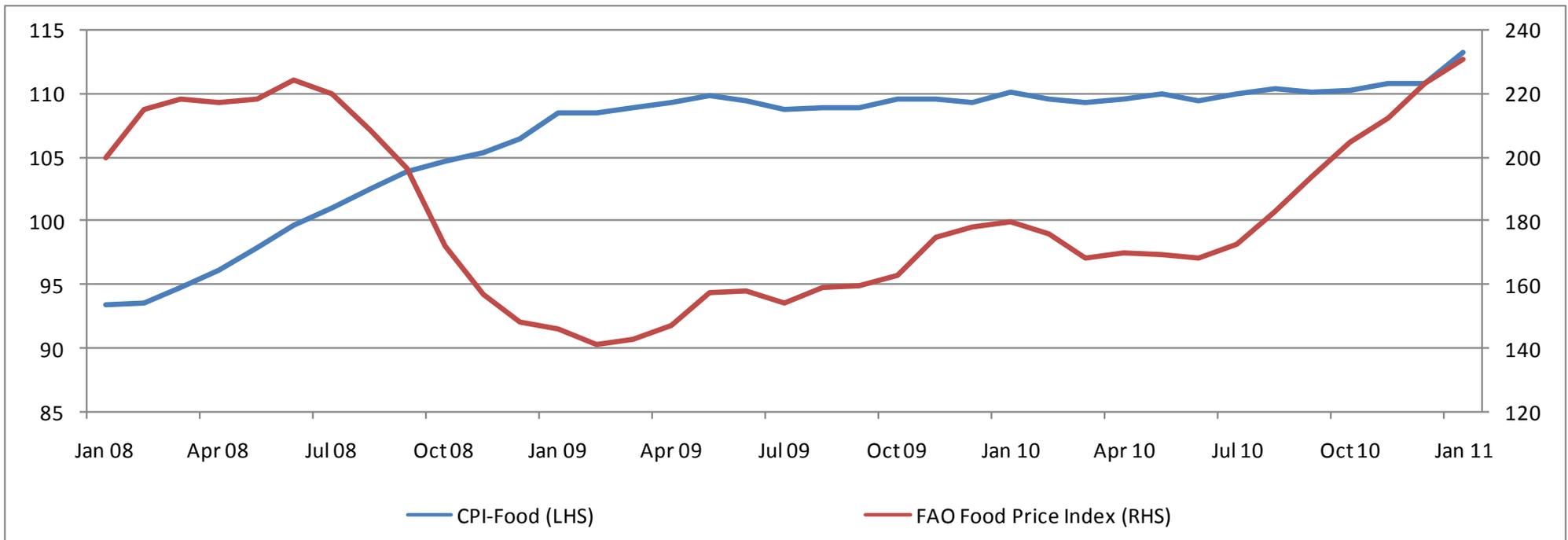
- The global recession has had an inconsistent impact on the manufacturing sector
- Automotive and Iron & Steel subsectors have been the hardest hit
- Very exposed to export markets / very sensitive to interest rate hikes
- Food and beverage sector was less affected
- Recession resilient, a step-up in demand for processed food products

Manufacturing production analysis: Y/Y volume and sales changes



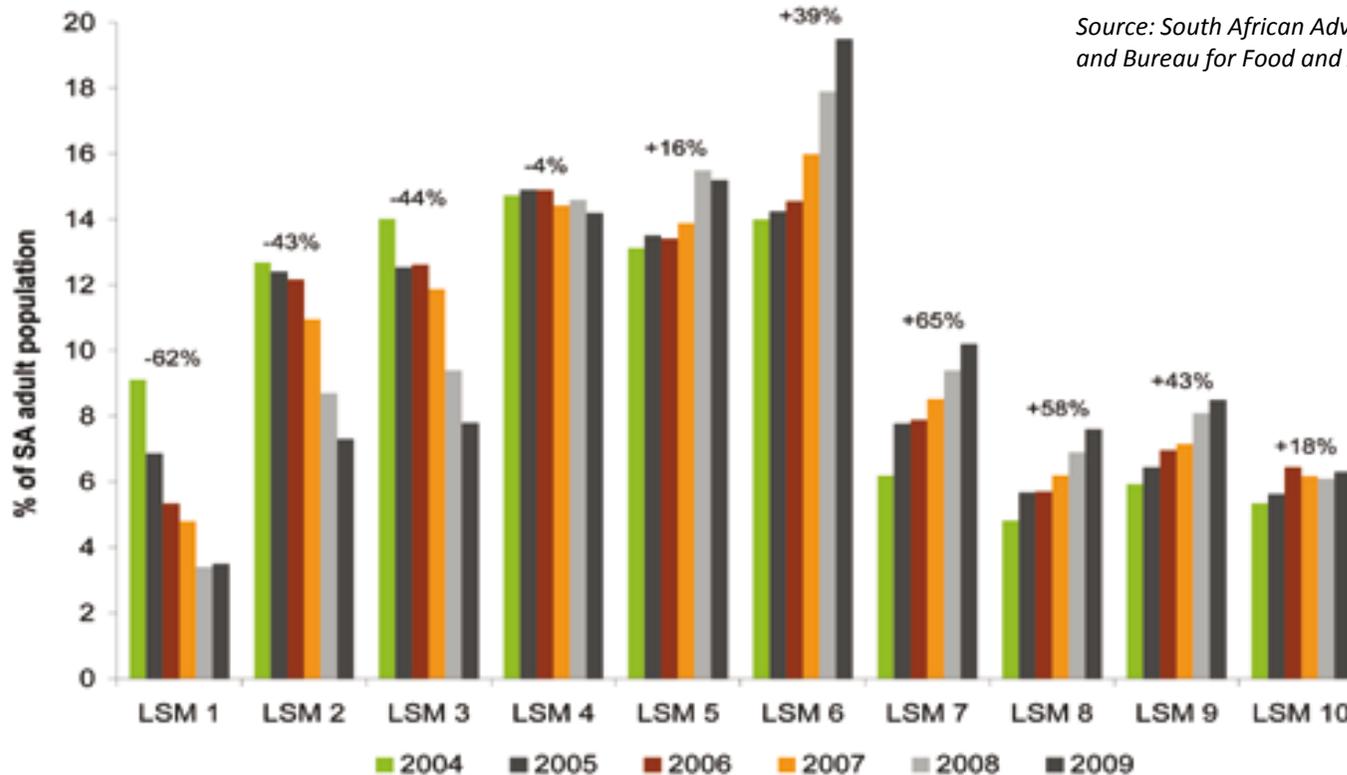
- Entrenched demand for processed food
- Capacity utilisation for food and beverages not as volatile as other sub-sectors
 - Remained above 78% through recession
 - Averaged 81% for 2008 and 2009
 - Latest statistics for November 2010 – 82.5%

Global and local food inflation



- In December 2010, FAO Food Price Index (FFPI) surpassed (slightly) its peak in June 2008, reflecting increases in world prices of all food commodities.
- In January, local CPI inflation rose by 3.7% y/y compared with 3.5% in December 2010 – driven by a jump in food and fuel prices both expected to rise further over the coming months
- SA's food price inflation is still in low, single digits because of previous favourable weather conditions, modest demand and a bumper maize harvest.
- Risk is that SA's food production could fail to meet demand, potentially because of widespread flood damage and other detrimental weather conditions, necessitating imports.

LSM class mobility and consumer trends



- South African consumers characterized by class mobility, where consumers migrate to higher LSM groups driven by economic growth as well as socio-economic empowerment.
- Consumers have become sceptical about functional foods and are now increasing focus on foods with traditionally perceived health benefits, e.g. fruit, vegetables and milk.
- Consumer wants more exciting, diverse and more sophisticated food experiences, e.g. refined product presentation, food products with rare or noble ingredients and interesting taste combinations and a focus on food from different cultures.
- Increased concern regarding ethical and environmental concerns - food manufacturers expected to rebuild brands through ethical efforts.
- Consumers still challenged with insufficient time in daily schedules – convenience foods growing but significantly impacted by economic climate due to premium associated with convenience foods

Impact of the recession on companies



Most notably:

- Reduced turnovers
- High levels of unutilised capacity
- High levels of gearing – too much debt
- Poor cash-flow
- Slow payment from debtors
- Increased bad debt levels
- Job losses
- Closures



South African banks remained resilient..



- **South African banks remained fairly resilient through the economic downturn due to:**
 - **All registered banks in SA are rigorously regulated by the South African Reserve Bank (SARB) irrespective of the nature of their business model**
 - **Adopted a strong culture of risk management that is embedded in the sector**
 - **Exchange controls and the structure of the domestic money market have prevented an exodus of liquidity from the country**
 - **Early implementation of the Basel II requirements by South African banks has resulted in improved risk management (Basel II is an international business standard that requires financial institutions to maintain enough cash reserves to cover risks incurred by operations)**
 - **The early introduction of the King 2 Code on corporate governance has created substantial focus on the governance of companies and banks in South Africa.**
 - **The timely promulgation of the National Credit Act has also served to moderate the supply of consumer credit**

Post recession challenges for SA banks..



- **Challenges faced post recession:**
 - Although SA's banks have been able to access local funding sources successfully, the cost of funding, especially for longer holdings, has become more expensive (given the structure of our money market, less than 10% of bank funding is raised internationally)
 - Maintaining balance sheet growth and profitability. The economic downturn coupled with domestic economic conditions in South Africa has caused a decline in aggregate demand, leading firms to cut investments and working capital and, ultimately, bank credit. Firms are delaying investment and borrowing decisions
- **Banks need to:**
 - Mitigating against pro-cyclicality - banks will be required to hold more capital during periods of high economic growth and to maintain prudent lending criteria. A larger capital buffer will sustain lending during more challenging periods
 - Given that the origins of the credit crunch lay primarily in derivative instruments, there has been a specific request to improve transparency of the credit derivatives markets
 - One of the major drivers of the crisis was compensation practices and the fact that excessive risk-taking led to excessive short-term rewards and incentives. As a result, there has been a call to review compensation practices and their relationship to risk-taking and innovation
 - Assess and manage risk more prudently and systematically

Surviving a tough climate: The elements of success

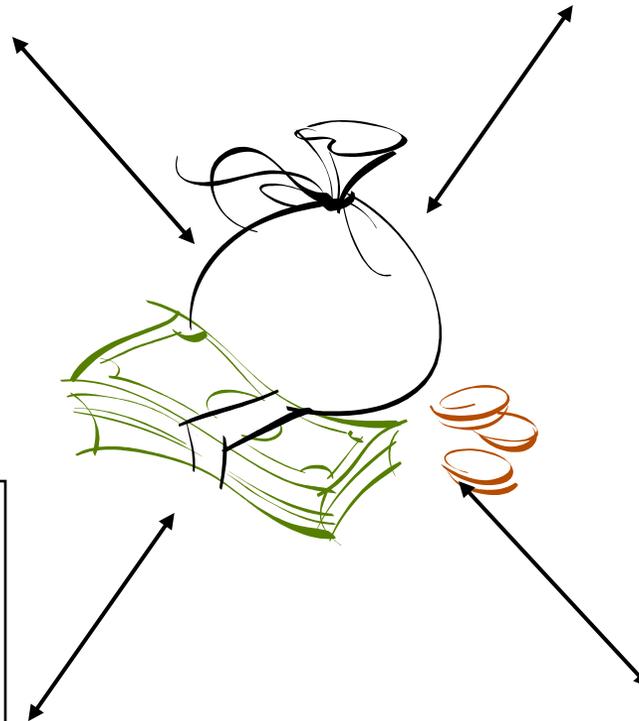


Market Factors

- **Business plan** – backed by in-depth business research
- **Focus** – clearly defined & well communicated priorities
- **Experience & skill** – business & technical
- **Product** – ability to adapt to changing market needs
- **Competitive advantage** – sustainable
- **Suppliers & buyers** – relationships, concentration levels, reliability, negotiating power
- **Marketing** – clear target market, not too strong reliance on one customer/market, ability to adapt to a changing market, realistic sales expectations

Financial Factors

- **Good capital structure** – Do not start off with too little money or too much debt
- **Cash flow** – Manage cash flows vigorously
- **Cost management** – controlling controllable, preparing for volatility in uncontrollable costs (energy, labour, inputs)
- **Bad debts** – Minimise the risk of non-payment



Operational Factors

- **Quality** – Non-negotiable
- **Increasing efficiencies** – optimised production levels, production cycle times, energy efficiency, unit labour cost
- **Cost management** – Reduce wastage and re-work
- **Pricing** – Set prices inclusive of all applicable costs
- **Government grants** – Be aware of all schemes ie. Dti MIP scheme
- **Full regulatory compliance**

Human Resource Factors

- **Effective workforce recruitment** – the right staff performing the correct tasks
- **Performance** – measurement and motivation
- **Succession planning** – skills development
- **Effective delegation** – eliminate the need to micro management
- **Conflict management** – reduced risk of strikes

Building a resilient business



- Manage cash flows vigorously & Improve cash conversion cycle
- Reduce input costs and overheads without compromising on quality
- Try to negotiate better discounts and payment terms for inputs
- Minimise wastage and re-work
- Optimise your energy consumption and consider the environmental impact of your manufacturing processes
- Ensure your product meets your target market needs
- Ensure that your product is not under priced
- Be aware of all support and incentive schemes that you might be able to access
- Ensure compliance with all regulatory requirements
- Optimised risk profile
- Stay abreast of technological and production advances
- Work closely with your banker





Absa Business Bank: Manufacturing Sector

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