

# Macro Pitch – Short South Africa

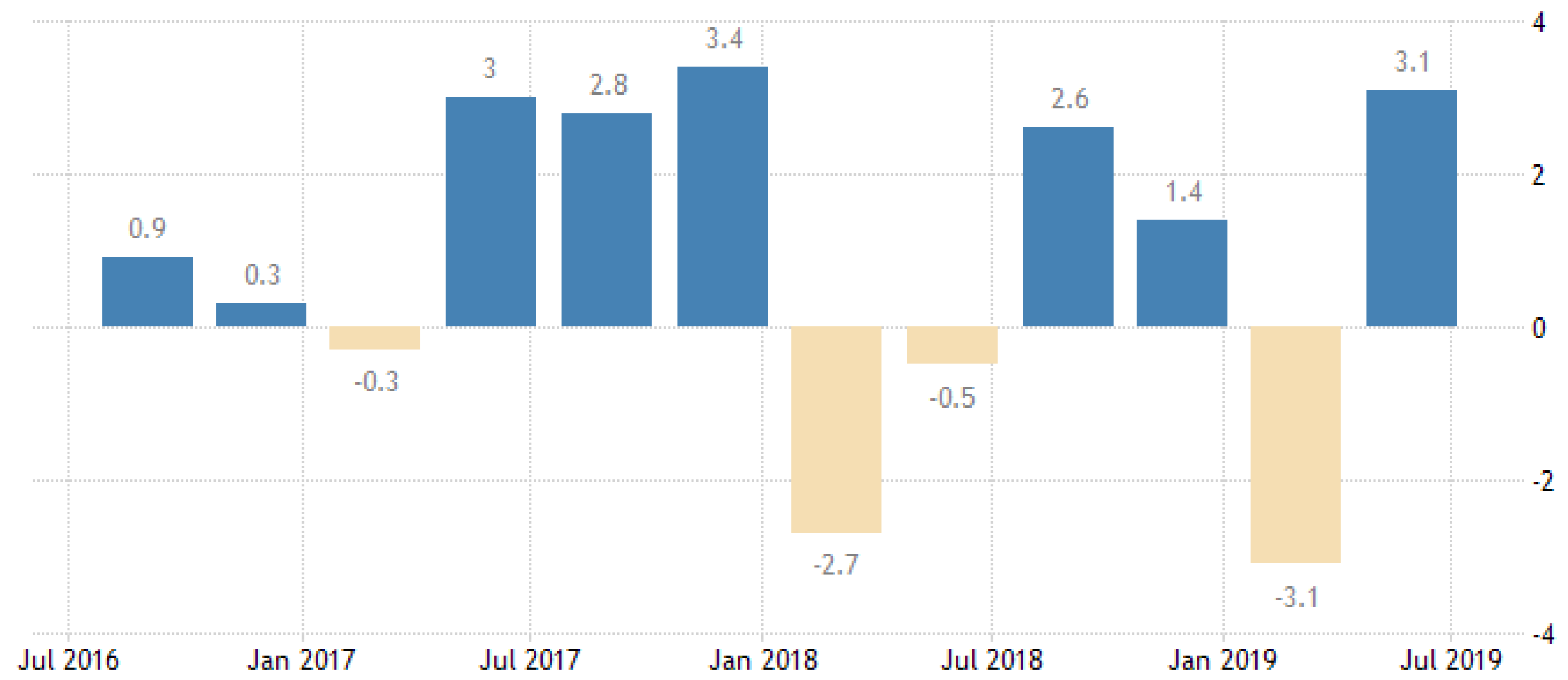


# Overview of SA Economy

- ❖ Mining, agriculture, and manufacturing focused.
  - ❖ Mines coal, platinum, diamonds, palladium mostly (other metals too)
- ❖ State owned energy production
- ❖ Lots of political instability (political upheaval most recently but apartheid historically)
- ❖ History of government corruption- lots of political inefficiency
- ❖ High economic inequality

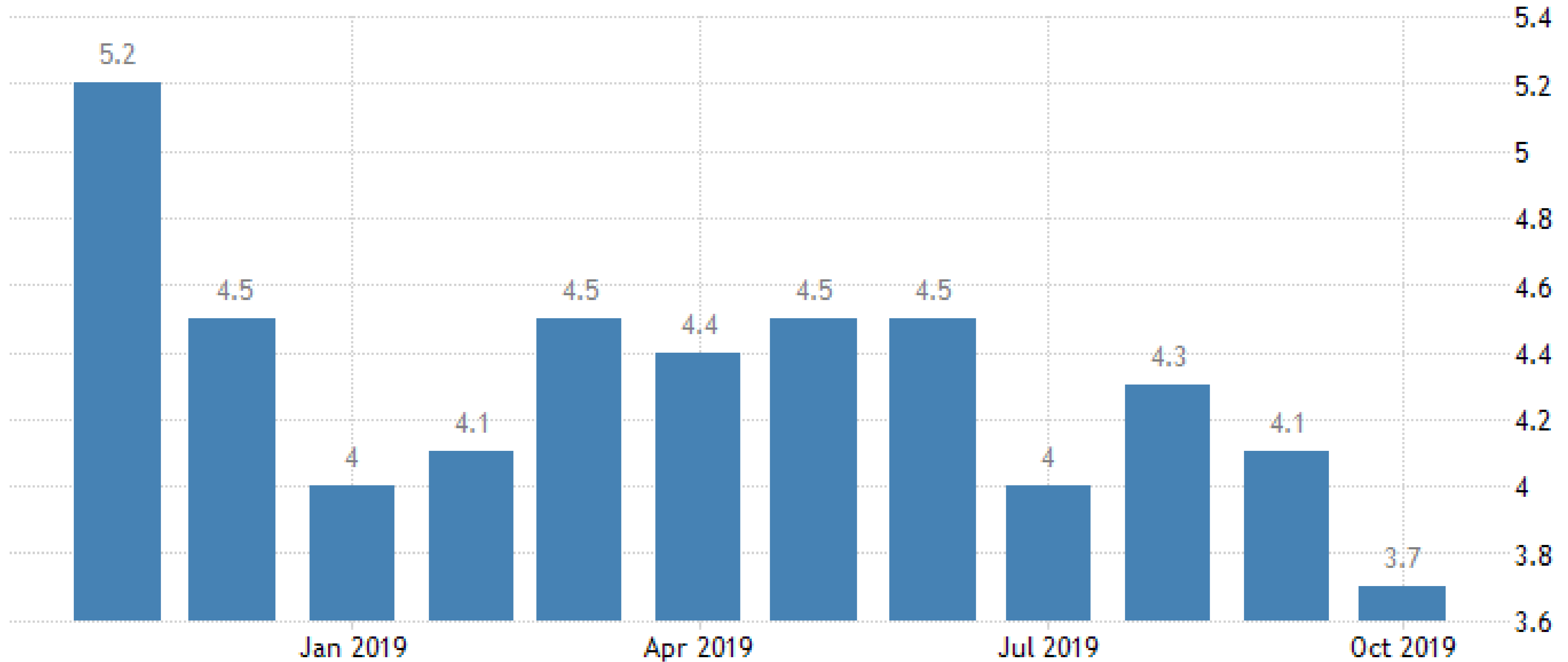
# GDP Growth

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# Inflation Growth

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# Central Bank Interest Rates

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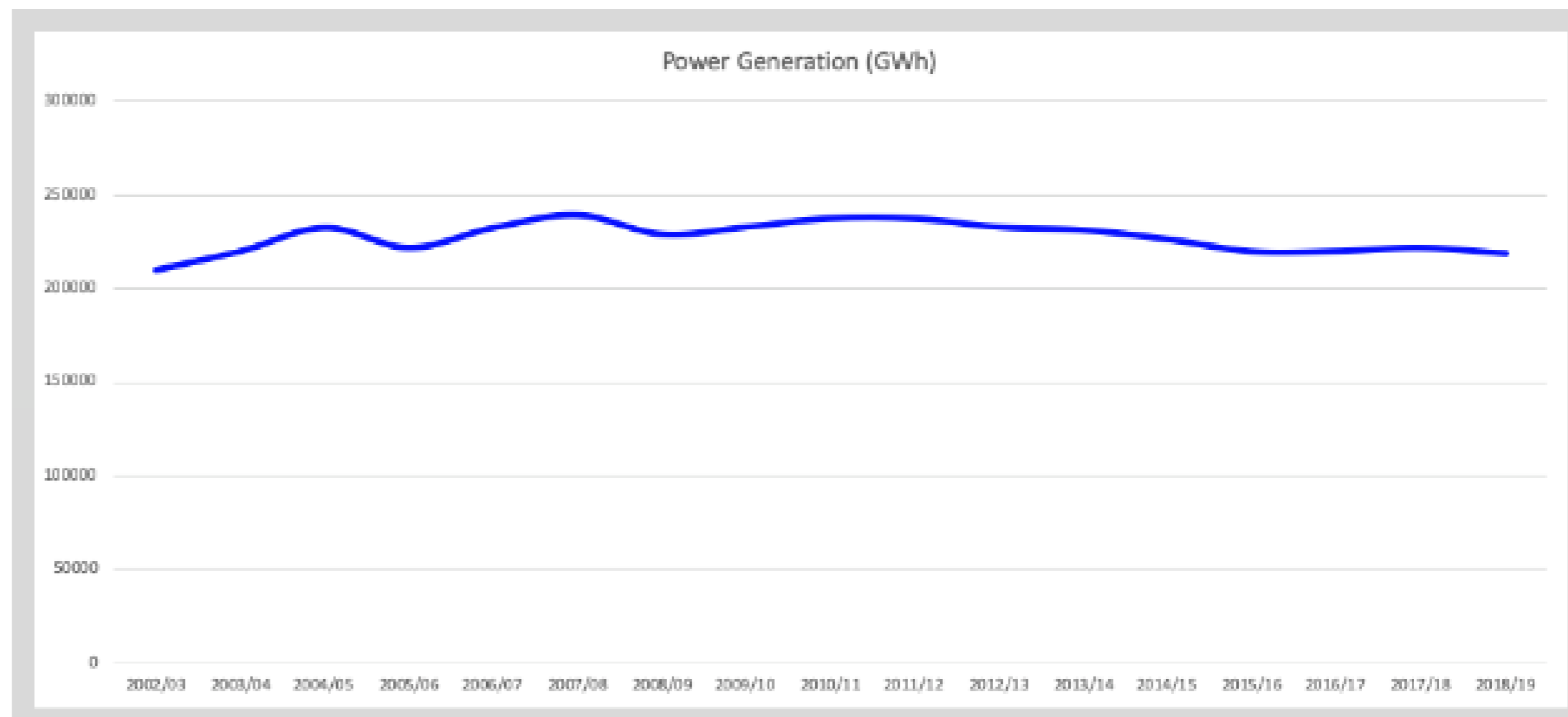
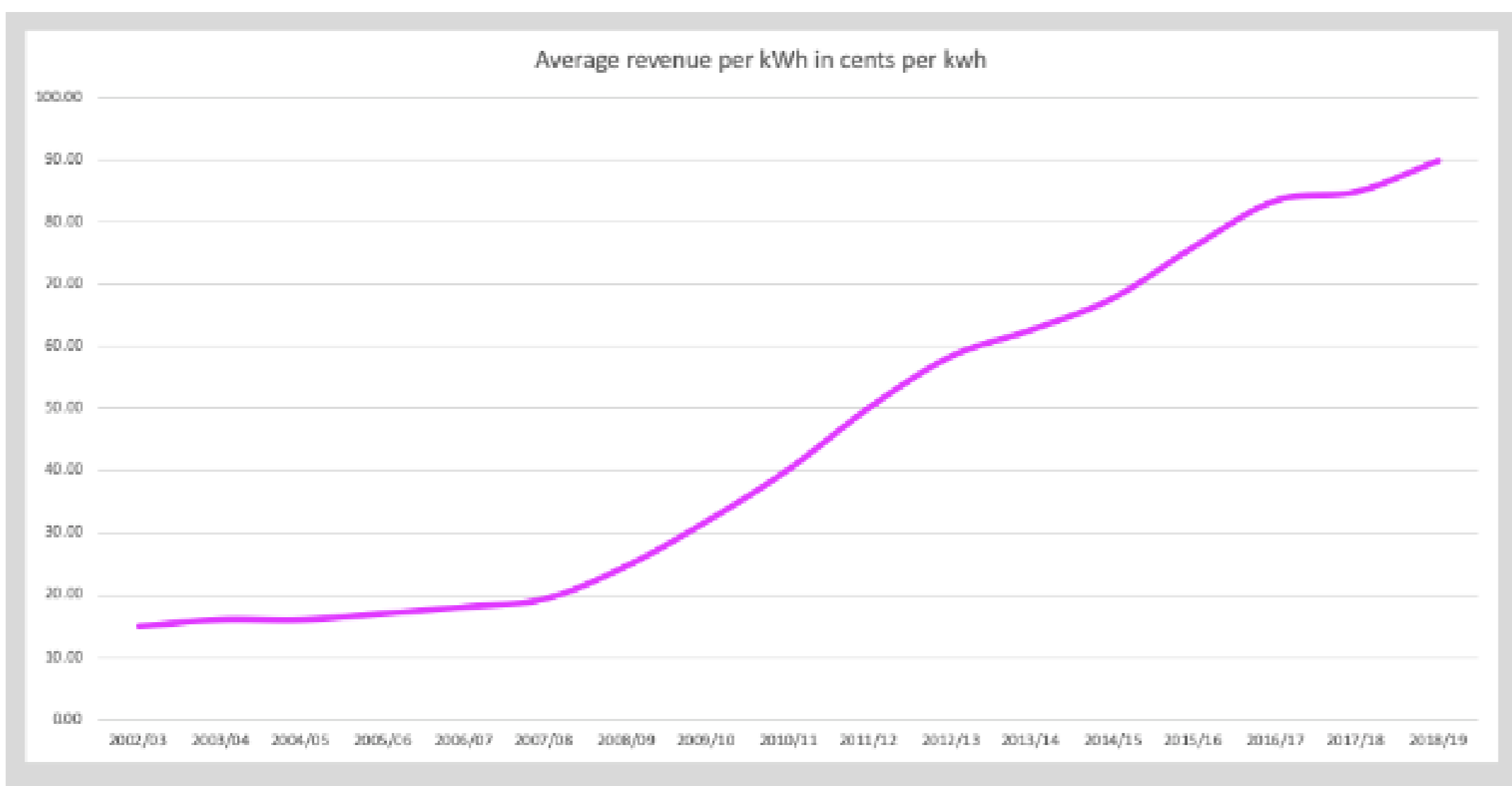


# Eskom Overview

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- ❖ State owned electric utility (generates 95% of country's electricity)
- ❖ Issues began during commodities supercycle in Africa
- ❖ Issue comes from lack of capacity expansion, old EQ, inefficient capex spending, high costs, lack of revenue collection, rising labor prices
- ❖ Highly indebted (R441B in debt )

# Average Revenue v. Power Generation



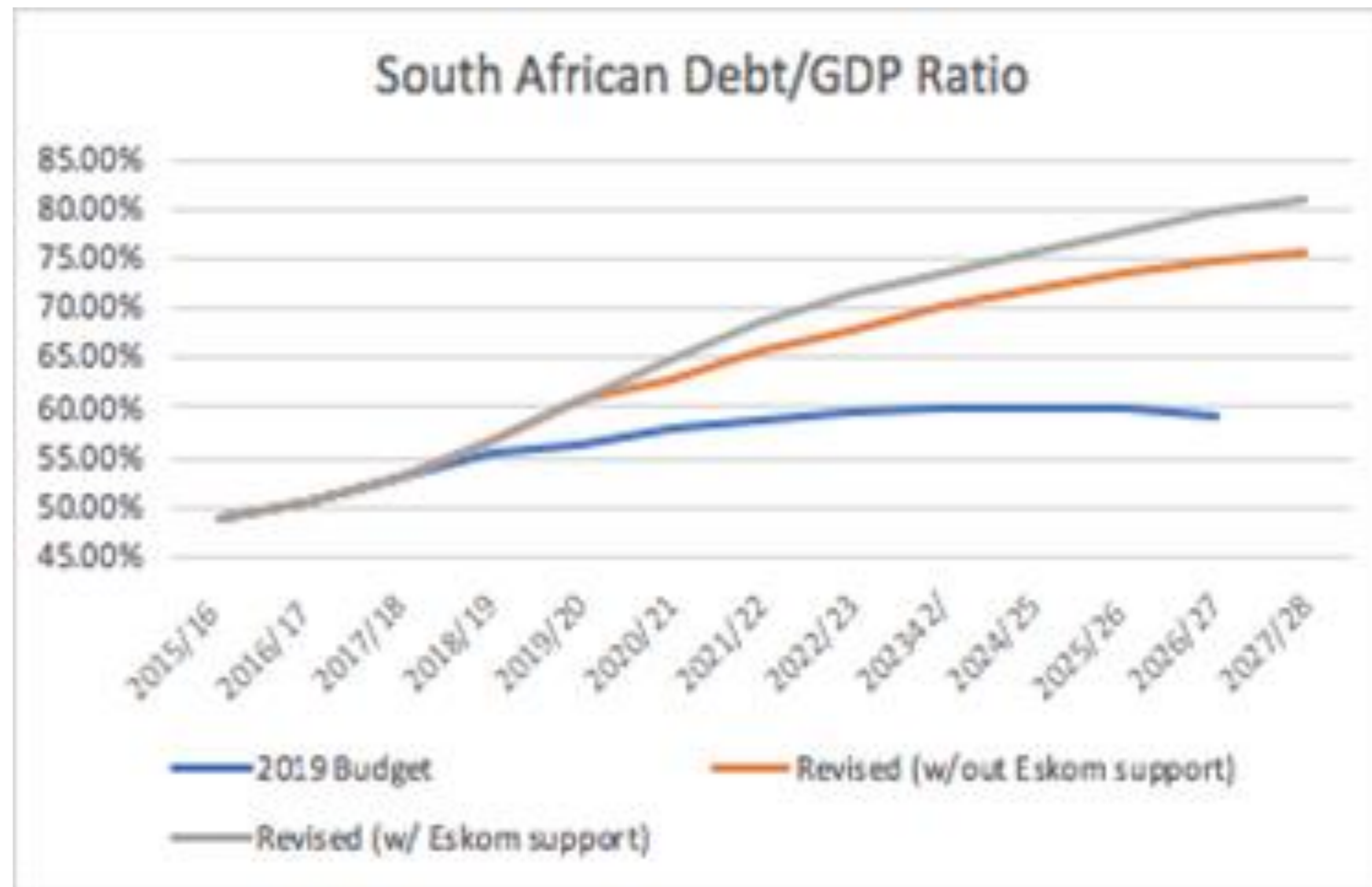
# Eskom Bailout

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- ❖ Recently, all of these issues blew up and Eskom realized they would not be able to finance their debt → going to be bailed out by the government
- ❖ Bailout proposed giving Eskom R49B (o/w R13B has already been disbursed) this year fiscal year, followed by R56B next year and R33B the year after.
  - ❖ Bailouts increase country's debt/GDP ratio
    - ❖ By 2027-28, this new budget would push public debt above 80% of GDP, from its current 55.6%.
    - ❖ Government already at last IG rating for credit (Eskom poses a large issue)



# South African Debt/ GDP Ratio



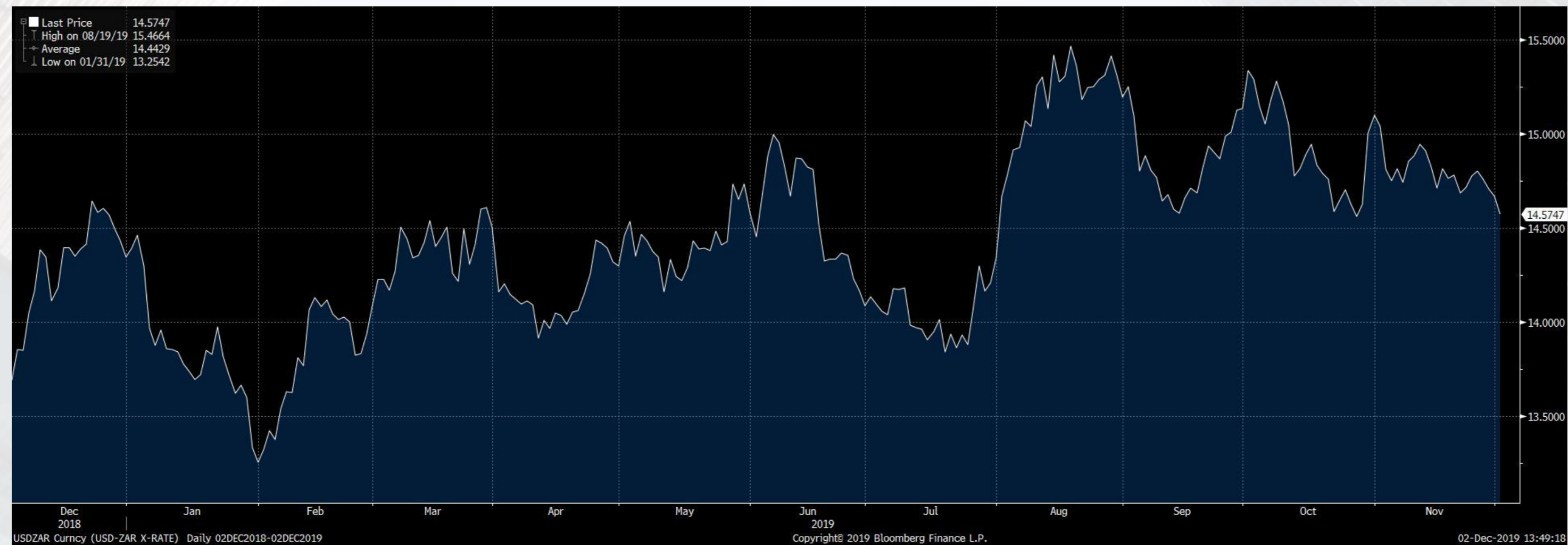
# Impact of Eskom

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- ❖ More power outages → less economic output
- ❖ Less income, less GDP, less employment
- ❖ What asset classes does this impact?

# USD / ZAR

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**Long or Short ZAR?**  
**Is this is a good trade?**

# Bonds / Yield Curve



What has happened to the curve in 1 year? What do you think will happen next?

# 10 Year Bond Yield

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# Our Logic:

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- ❖ Bonds, currency, yield curve moves on a lot of news and can be volatile- also a lot of this bad news is priced in
  - ❖ Unique way we can be short South Africa?
    - ❖ Short consumer credit

## Our Thesis:

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- ❖ More power outages is going to force companies to produce less and in general, create less economic output.
  - ❖ This should hurt consumers wages.
  - ❖ Consumers, on a relative basis, are already highly indebted and spend a lot of their paycheck to pay debt so wage and salary cuts should result in consumer defaults
  - ❖ Unsecured credit market in South Africa is hot right now

# Unsecured credit market cycle

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- ❖ Following Apartheid, there was expansion in unsecured credit market
  - ❖ Banks began targeting these consumers with high rates and government attempted to regulate this behavior
  - ❖ Eventually, people began defaulting and 2 unsecured lenders went bankrupt (government had to step in)
- ❖ Government steps in and sets max interest rates and borrowing amounts
  - ❖ Banks circumvent this by charging transaction fees and insurance income
- ❖ Today these fees still exist
  - ❖ To avoid taking on losses, banks are extending loans- we this because loan maturities have migrated from 19-36 months to >36 months.



# Overview Banks

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- ❖ Banks are balance sheet businesses
  - ❖ Assets are loans they make
  - ❖ Liabilities are deposits they have
    - ❖ Earn income on this spread
- ❖ Banks typically need to be well capitalized to support liabilities in case deposits dry up
  - ❖ Capital ratios are important to look at
    - ❖ CET1 Ratio (Common Equity Tier 1 Ratio)
      - ❖ **Common equity tier 1**- equity, AOIC, retained earnings etc
      - ❖ Common equity tier 1 is apart of Tier 1 Ratio
        - ❖ **Tier 1 Ratio**- (equity capital+ reserves)/ risk weighted assets

# Overview Banks

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- ❖ **P/B ratio**- Price of Equity/Book value of Equity (also Price of Equity/ Book Value of Assets- Liabilities)
  - ❖ Why is this better/different from P/E?
  
- ❖ **ROE** on banks:
  - ❖ Net Income/ Shareholders equity
  - ❖ What does this measure?

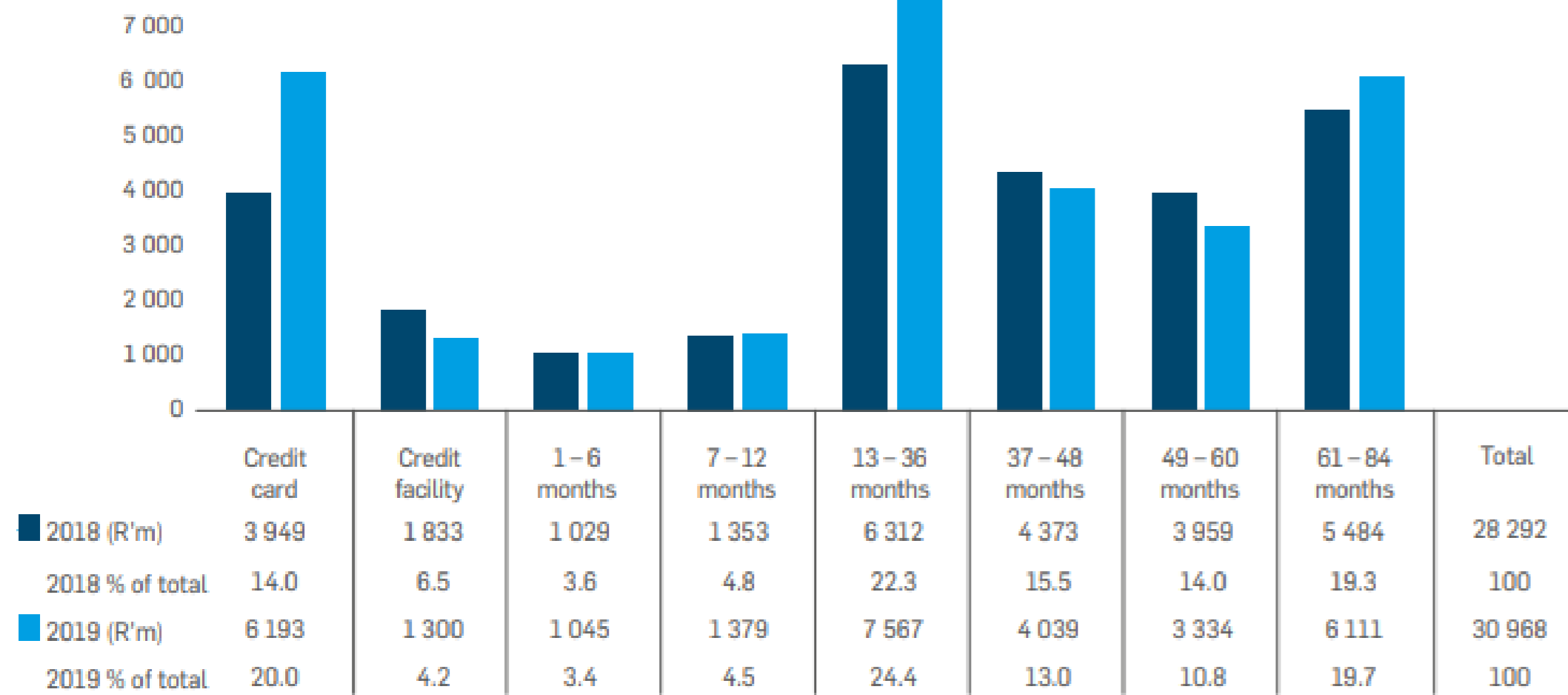
# Short Capitec Bank

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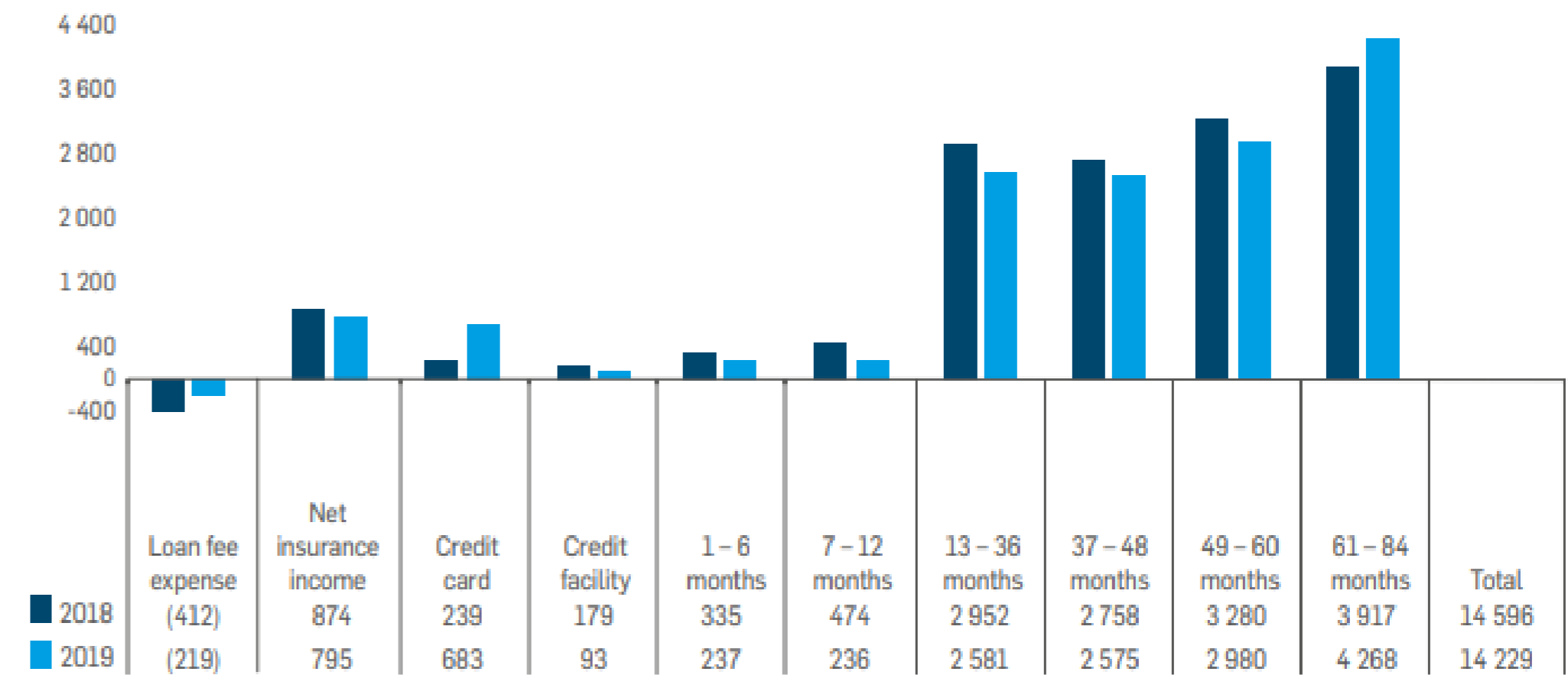
- ❖ Banking environment is relatively concentrated
  - ❖ Big 4 Banks → Capitec grew the fastest following the last credit crisis because it had the lowest transaction fees and lowest loan fees
    - ❖ Grew mostly in volume
    - ❖ Specialized mostly in personal unsecured lending and high market share in low income segments.
- ❖ Capitec is trading at 7.2x P/B, has a CET1 ratio of 32% and an ROE of 27%

# Lending Profile

LOAN SALES BY PRODUCT (R'm)

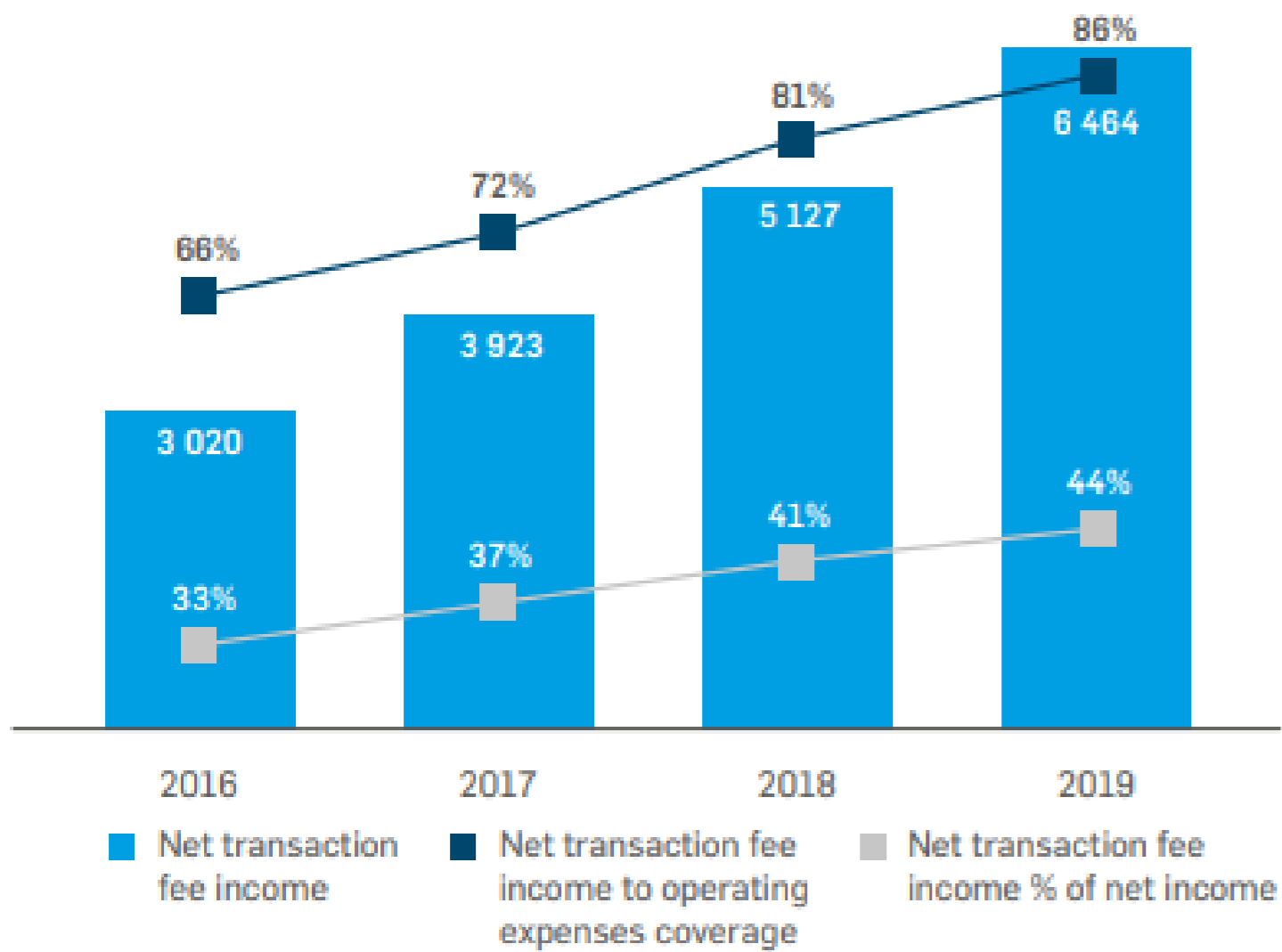


TOTAL NET LENDING AND INSURANCE INCOME  
(EXCLUDING INVESTMENT INCOME) (R'm)

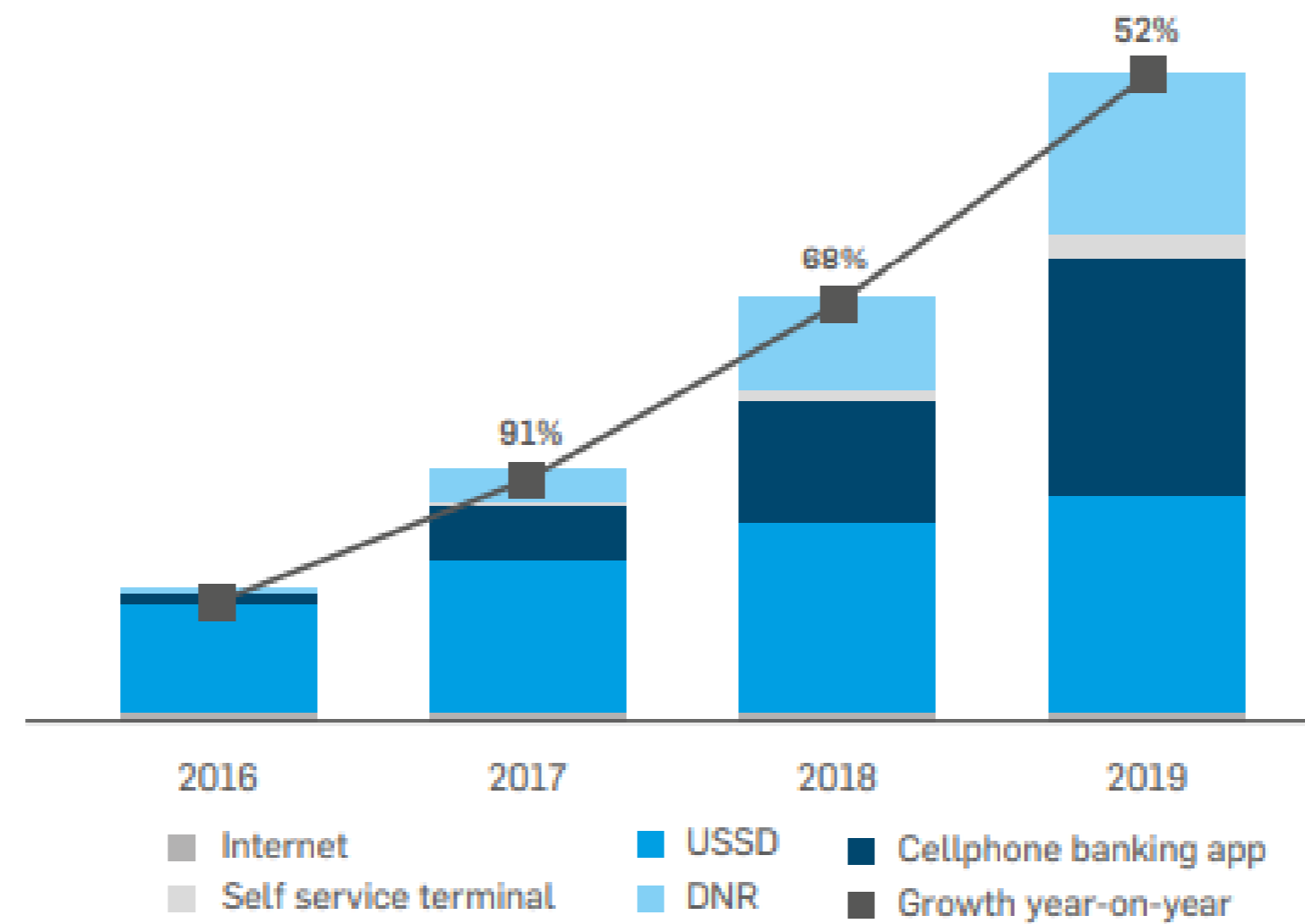


# Fragilities

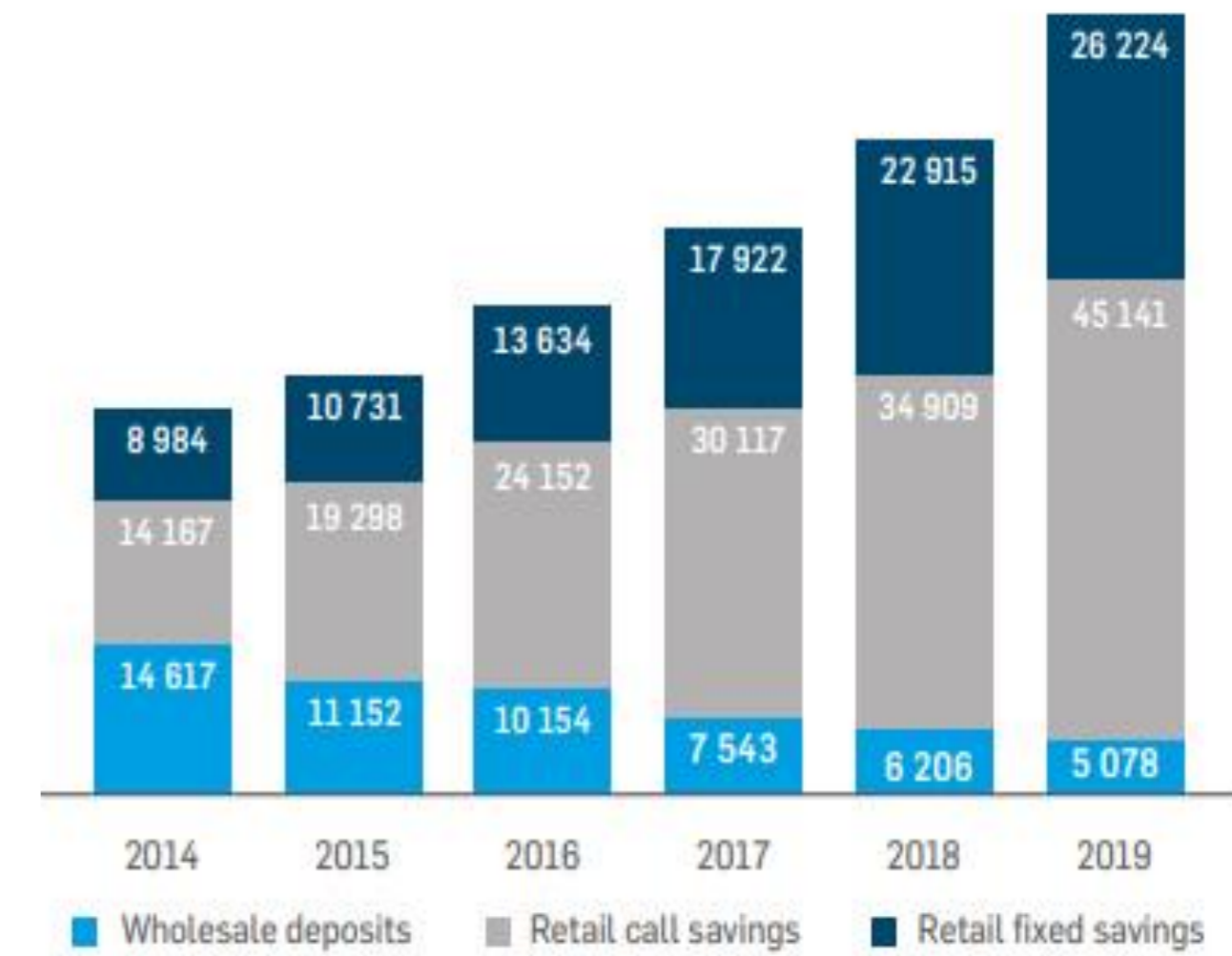
NET TRANSACTION FEE INCOME (R'm)



SELF SERVICE BANKING (R'm)



COMPOSITION OF DEPOSITS (R'm)



# Risks

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- ❖ Growing transaction fees (very unclear on how this works based on what we could find)
- ❖ Government bailout (risk of major bank facing trouble)
- ❖ Expensive to short (borrow probably very high)
- ❖ Earnings management continues to obscure true credit profile

# Catalysts

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- ❖ Negative data on unsecured lending
- ❖ Poor earnings report
- ❖ Short reports by funds
- ❖ Unsecured credit market drawdown