



THOMAS WHITE - GLOBAL INVESTING
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Country Profile: South Africa

May 2010

It has never been more important for you to understand what is occurring in the world beyond your country's borders. Whether you realize it or not, we are now all fellow citizens...Global Citizens.

The Thomas White organization was founded in 1992 with the goal of bringing the benefits of globalization to investors around the world. We believed that once investors understood that globalization was a positive force, they would also see the advantages of adding international equities to their portfolios. It only makes common sense that professional investors would begin searching the globe for the most attractive opportunities. Researching a wider universe of companies should improve long-term performance. Moreover, broad diversification typically lowers return volatility. Multinational corporations have been using this global strategy for years; why shouldn't investors do the same?

Now 15 years later, our firm growth and strong subsequent portfolio performance has confirmed our investment premise. Currently, Thomas White professionals are performing research and managing over one billion dollars in close to 50 countries. We believe one reason for our success is that the nationalities of these analysts are as globally diverse as our portfolios.

A handwritten signature in dark ink, reading "James S. White, Jr." in a cursive style.



Relief carving on the pediment of the oldest structure in South Africa, the Castle of Good Hope: The building was originally built in 1652 as a fort by Jan Van Riebeeck, head of the Dutch expedition which founded Cape Town.

South Africa: It's Possible

The “Rainbow Nation” of the world is a kaleidoscope of scenic beauty, but also a mélange of multicultural and multiethnic people and heritage. With exceptional sights like the oldest meteor scar on earth, proto-mammalian fossils, and three billion old rocks, South Africa is a feast for the eyes. This super power of the African continent has risen from the ashes of apartheid to the present day of progression and development.

The largest storehouse of the world's precious resources like platinum and gold is also a major producer of diamonds, manganese, coal and chrome. Holding some unique distinctions, South Africa is the home of two Nobel Prize laureates Dr. Nelson Mandela and Archbishop Desmond Tutu, the site of the first ever heart transplant in 1967 and will be the first African nation to host the FIFA World Cup in 2010.

Turbulent times

South Africa is proud of its history dating back three million years, when one of the earliest progenitors of the human race, *Australopithicus Africanus*, existed in the country. The San and Khoikhoi aboriginal tribes were early inhabitants, followed by the Bantu speaking tribes who usurped most of the arable land. Yet, the most important milestone in the history of South Africa was marked in 1652 by the entry of the Dutch East India Company, headed by Jan Van Riebeeck, who established a fort and provision station for company ships on long journeys around Africa to Asia. The Company also encouraged immigration by other Europeans like the Germans and French, and allowed its employees to establish farms. These Dutch farmers, known as Boers, bartered with the Khoikhoi tribes initially, but began a gradual takeover of their land,

battering the tribe with violence and disease. The Dutch also brought in slaves from the Asian countries and other parts of Africa.

In 1795, France conquered the Netherlands, and the British arrived on the scene to keep this valuable outpost out of French hands. In 1814, the Netherlands formally gave the Cape to the British. But the Boers soon began to resent the British control. This resentment reached a fever pitch in 1870, when a diamond field was discovered in Kimberley. This changed the picture entirely, with both the Boers and British staking a claim on the land. With the lure of wealth beckoning, the Dutch Boer resistance grew stronger, resulting in the first Anglo–Boer war. The Boers triumphed, forming the Zuid-Afrikaansche Republiek. But as new reserves of gold were discovered around Johannesburg in 1866, the British again were driven to war in hopes of securing the newfound treasure. The Boers ran out of resources needed for a second war and resorted to a guerilla style of warfare. This time, the British overcame the Boers and triumphed. In 1902, the Boers signed a treaty of peace with the English and the area was colonized under the British.

In 1910, the Union of South Africa was formed, under British rule. The country’s constitution gave whites complete control, paving the way for racism and discrimination against non-whites. Differences between the British and the *Afrikaners*, as the Boers came to be called, also continued. In 1948, the Afrikaner-controlled National Party, seized power in the elections. Intolerance against blacks and non-whites, which had become a matter of custom, was consecrated by law in 1948. Apartheid (“*apartness*” in Afrikaans)

ensured that there were separate areas earmarked for each group; whites, blacks, coloreds (a group formed by the intermingling of early Afrikaners and blacks) and Asians.

Every individual’s race determined his social status, and the place where he lived, prayed, worked and learned. Blacks were divided into ten different ethnic groups and each assigned a particular area called the *Bantustan*. These areas were bereft of any infrastructure, industry or

South Africa and the World	
Nominal GDP (\$)	276.445 million
GDP Rank	31/186
Per Capita GNI (\$)	9,790
Per Capita GNI Rank	96/210
Population Rank	25/227
Geographical Area Rank	25/250
Global Competitiveness Rank	45/139
Economic Freedom Index Rank	72/179
Human Development Index Rank	129/182
Major Industries	Agriculture, Technology, Textiles, Chemicals

resources needed to cultivate adequate food. Widespread unrest spread all across the country. There were strikes and protest marches by blacks against discrimination. Parties such as the African National Congress (ANC) led by Nelson Mandela were forerunners in the equality struggle. The Sharpsville Massacre drew international outrage and support for the cause.

South Africa had to cope with international isolation as it faced political and economic sanctions by the UN and its withdrawal from the Commonwealth. As the protests increased and sanctions began to hurt, the *Rand* collapsed. FW De Klerk, who came into power in 1989, was a reformist. He released political prisoners, annulled all apartheid policies and started negotiations for inclusion of blacks into the government. After long and difficult negotiations, both the parties agreed to institute a nonracial, nonsexist, unified, and democratic South Africa based on the principle of “one person, one vote.” Free and fair elections were held in 1994, resulting in a landslide victory for the ANC. Nelson Mandela became the president of a liberated and new South Africa.



The Victorian Gothic clock tower holding vigil in Cape Town's Victoria and Albert harbour is a remnant of South Africa's British colonial past. Completed in 1882, the tower housed a mirror room which allowed the Port Captain to view of all activities in the harbour.

The new government was then faced with a crucial task of restructuring the economy and ensuring equitable distribution of economic benefits for all. Notwithstanding the enormity of the challenges faced, South Africa's transition to a constitutional democracy and its economic progression later is nothing short of a miracle in and of itself.

A big warm *potjie* of culture

South Africa represents a vibrant intermingling of various cultures and languages. As defined by apartheid of yesteryear, four main groups exist: whites, blacks, coloreds (mixed race) and Asians. Cultural differentiation between each of these is quite explicit. While the lifestyle and customs of the whites, comprised mainly of urban

inhabitants, is roughly parallel to those in European or Western culture, the blacks follow their native customs and mainly are rural dwellers. The colored people culturally mirror the white population. A minority of coloreds are also Muslims, more popularly referred to as Cape Malays. Asians are predominantly of Indian origin and follow Indian

customs and speak Indian languages such as Hindi, Tamil, Telugu or Gujarati. A small minority of the Chinese population is also counted among the Asians.

With such a population mix, South Africa officially recognizes eleven languages, and interestingly, the country has 11 official names, one in each of these languages. The most popularly spoken languages, however, are English, Afrikaans and Zulu.

South Africa offers a varied and interesting assortment of cuisine, art, music, dance, theatre and literature. The local cuisine is full of unique delights for the meek as well as the brave-hearted including crocodile sirloins, fried caterpillars, sheep heads, *biltong* (dried, salted meat), *bobotie* (a Shepherd's pie) and *boerewors* (hand-made farm sausages grilled on an open flame). The country is also well-known for its vineyards and wines. Music and dance in the country is hugely exciting and popular, especially the Afrofusion which combines formal dance training with a spirit that is purely African.

A turnaround story

The South African economy during the years of Apartheid was torn by economic sanctions, with foreign investors fleeing the country, and average growth rates ranging between 1- 2% until the 1990s. The economic performance of the country during the first decade of freedom was impressive on several counts. Growth rates demonstrated an upward trend and the real GDP averaged 3% in the period from 1994-2003 and an outstanding average of 5% in 2004-2006.

In 2006, the Gross Domestic Product (GDP) of the country stood at \$255 billion, with agriculture contributing 2.5%, industry representing 30.5 % and services amounting to a 67% majority share. South Africa has been witnessing an uninterrupted 33 quarters of expansion in real GDP since September 1999. This is the longest economic upswing in the

country's history. Development has been fueled by investment and thriving consumption.

Known as the Accelerated and Shared Growth

Initiative for SA (AsgiSA), the government of South Africa has embraced the goals of increasing



A Zulu woman strikes a pose: Over ten million Zulus live in South Africa, the country's largest ethnic group.

the growth rate to a minimum of 6% by 2010 and halving poverty and unemployment by 2014. Another program, Black Economic Empowerment, has fostered new economic opportunities for previously disadvantaged groups. With these and other initiatives, a new black middle class in South Africa has emerged.



Van Riebeeck is credited with planting the seeds of interest in South Africa's wine industry. Today, South Africa boasts a burgeoning wine industry, ranking seventh in world in production.

Economic engines

Agriculture, though a very minor contributor to the overall GDP, is well organized. Large tracts of land, together with a long 1875 mile coastline, foster the production of a wide range of marine and agricultural products. Africa has a dual agricultural economy catering to both commercial and subsistence based production. Maize, wheat, oats, sugar cane and sunflowers are the country's major agricultural products. South African agriculture has evolved from a

highly regulated and protected industry to one that is market-oriented. It is unsubsidized by the government and has turned into a highly competitive, level playing industry. Therefore, the country is not only self-sufficient but is a net exporter of agri-products. South Africa's agricultural sector boasts some clear competitive advantages. First, the country's growing season is opposite that of Europe, offering complementary market opportunities. It also has well-developed cold chain facilities and ports. South Africa's agricultural production has been commendable, with the exception of 2006 when the output fell by 14.9% due to low crop prices. But as global commodity prices heat up to record prices, South Africa should hear its cash registers ringing all the way. A resource rich country, South Africa boasts an abundance of mineral resources. In fact, the wealth of the country has been built on these resources. It holds nearly 90% of the platinum metals on earth, 80% of the manganese, 73% of the chrome, 45% of the vanadium and 41% of the gold. The mining industry is the biggest employer, with around 460,000 employees and another 400,000 employed by the suppliers of goods and services to the industry.

Gold production, which once formed the backbone of the economy, has lost its luster in recent years. In 2007, China displaced South Africa as the world's largest gold producer. 95% of South Africa's gold mines are underground operations, reaching depths of over 3.8 km. With declining grades, increased depth of mining and mining costs, and a slide in gold price in the 1990s, production fell. As one of the world's largest producers of gold, South Africa is more susceptible

to slumps in price because its deep level mines are the highest cost producers in the world. However, the sector should see a revival in the current year, on the back of rising gold prices. Nonetheless, South Africa's mining sector continues to be the top FDI recipient for the country.

South Africa's vehicle production is becoming a booming industry as well. It is the second largest area in the manufacturing sector and the fastest growing. Almost every global auto major, has its operations based in South Africa. Other major industries in the country are chemicals manufacturing, metals processing and pharmaceuticals. South Africa hosts a number of superior quality hospitals and well-trained medical staff which has helped lure investments into the pharmaceutical sector. The fertilizer industry also looks promising due to the country's large-scale diversified agricultural sector. Expansion in the Information and Communications Technology and electronics industry has also been phenomenal, with the average growth of the country surpassing the world average.

Yet, all is not sunny in paradise. South Africa's textile industry has taken a hit due to increasing competition from Chinese goods. Fighting back, the South Africans have responded with new innovative textile products. The production of improved parachute fabric, technically knitted fabric used in bomb disposal, fire retardation kits and specialized medical textiles are making their mark in niche markets.

The services sector is the major contributor to the GDP, comprised of financial services, tourism, retail sales and telecommunications. South Africa possesses a robust and mature financial services sector, which is comparable to the best in the world. The country's banking sector has a good representation of foreign banks and offers modern services like a nationwide network of ATMs and Internet banking services. Mzansi, South Africa's innovative new low-cost banking scheme provides banking services to more than 3.3-million low-income earners - a vast and growing market previously untapped by the financial sector.

With 400 listed companies, the Johannesburg Stock Exchange is the only stock exchange in the country and the 16th largest in the world. Holding the distinction as the fourth-largest emerging market destination for investments, the exchange mopped up \$9.4 billion in 2005, up from \$1.5 billion a decade before.



These miners battle the elements at a depth of 1.86 miles in Gauteng, South Africa, where mining began in 1908. To produce one single ounce of gold, over 3.3 tons of ore must be blasted.

South Africa has seen a remarkable increase in tourist inflow in the recent years, climbing from 3.9 million in 2004 to 8.4 million in 2006. The nation comes across as an affordable tourist destination with everything ranging from beaches and wildlife to cultural and heritage sites. The FIFA World Cup to be hosted by South Africa in 2010 is expected to give tourism a major fillip.

The World Cup is acting as a catalyst for infrastructure and construction related activities in the country. Everything is being constructed new -stadiums, luxury hotels, roads, railways and airports- to meet the demand for the upcoming event. Significant investments have poured into the electrical sector, and also into the country's railways, ports and harbors.

The outsourcing industry has also discovered South Africa. Advanced telecom and financial systems, a favorable time zone, a huge English speaking population and excellent infrastructure set the stage for outsourcing enterprises. South Africa, which housed 494 call centers in 2004, expects to double that number by 2008. A top priority for the government is to make South



The tourism industry in South Africa is blossoming, accounting for 9% of the country's workforce, \$9.2bn in revenues, 8.2% of GDP and 8.4m tourists in 2006.

Africa the third biggest outsourcing center after India and the Philippines.

With an emerging black middle class, the retail sector in the country is roaring. Retail majors are on an investment spree, as the wholesale and retail trade, hotels and restaurants sector grew by 6.1%, contributing around 1% to GDP in 2006. But 2007 saw a slight slowdown in this sector due to rising interest rates.

Prudent policies and economic growth have resulted in a drop in South Africa's budget deficit (difference between government's total expenditure and its total receipts excluding borrowing) to a mere 0.3 % of GDP in 2005-06. This figure is estimated to inch up to 0.4% in the coming years. Consumer inflation raised its hood in 2006 to 6.8%, mainly on the back of strong domestic demand, rising wages due to labor market pressures, and climbing prices of imported goods like oil. The depreciation in the *Rand* further aggravated the situation. In order to contain inflation, key interest rates in the country have been raised.

Still some hurdles to jump

Notwithstanding an astonishing economic transformation, South Africa faces a magnitude of issues to resolve. Growing economic uncertainty, a weak power sector in the country with forced

power black outs, a steady rise in interest rates over the past two years, a depreciating *rand* and a slowdown in mining sector remain the main impediments. Though the depreciating *rand* makes a good case for a rise in exports, the manufacturing sector has almost reached its peak capacity.

This, coupled with rising interest rates and increasing power shortages, makes a ramp up in production next to impossible.

Despite the remarkable transformation undergone by the country, the level of job creation continues to disappoint. The government's delivery of public services like electricity, water and sanitation falls short due to a large-scale increase in the number of households and migration to urban areas. Sadly, the life expectancy in South Africa has drastically dropped down to 47.7 years from 57 years a decade ago. This is due to a high incidence of HIV infected people. A total of 5.4 million people are estimated to be infected, which includes 16.2% of adults from 15-49 years of age. High crime rates overshadow an otherwise prospering nation. Although there has been a fall in the overall crime rates, serious crimes have appeared to peak.

Recessionary troubles

Despite these problems, South Africa was in relatively good economic health prior to the recession. Initially it was anticipated that the country's low debt ratio, large cash holdings and foreign exchange reserves would cushion the impact of the global economic crisis. But by December 2008, South African factories had put up their worst performance in nine years. Interest rates were dropped for the first time in three years to tame inflation.

South Africa officially fell into recession for the first time in 17 years in May 2009, cutting short its decade long period of expansion. Soon, the South African economy was plagued by problems. The economy's dependence on exports dragged down the GDP by 6.4% in the first quarter, as global demand almost ground to a halt. With production slipping 17.1% year-on-year, the manufacturing sector, which forms one of the pillars of the South African economy, accounting for 15% of the GDP, plunged for the eighth consecutive month in May 2009. Unemployment, which was already high, skyrocketed to 23.6% in the second quarter of 2009, as mining companies and manufacturers laid off 267,000 workers. The slump in general government services, agriculture and the construction industry added to South Africa's woes.



Due to decades of cheap power supply, South Africa ran short of the finances needed to ramp up capacity. To improve the alarming power shortages in the country, the budget for 2008-09 has earmarked \$7.5 billion towards expansion and a total of \$43 billion to be spent over the next five years.

However, the stable macroeconomic policies that the country had previously put in place came to the country's rescue. Thanks to economic prudence, South Africa's national government debt, which had ballooned to 48% of the GDP in 1998, was trimmed down to just over 27% in 2007. South African banks had limited exposure to foreign assets and they were sheltered by low leverage and high profitability. A constant and organized flow of funding did not interrupt their liquidity, which eliminated need for financial crutches from the government. The country's money markets too remained substantially systematic and stable.

Due to these factors, South Africa could do without a stimulus package. Instead of introducing a consolidated economic package, the government plugged the holes in its economy one by one. It increased the budget deficit, provided loans to companies in need, set up a fund to retrain laid off workers and put in place public works programs to provide temporary employment. In a way, South Africa's recession encouraged progress in overall development. South African President Jacob Zuma revealed plans to provide more housing facilities, and improve literacy. What's more, to tackle the country's dire electricity problem, he asked independent electricity producers to contribute to the national grid. Apart from this, the government is planning to spend \$110 billion on infrastructure over the next three years, which will create jobs and encourage growth.

Silver linings

With the help of such measures, South Africa managed to pull out of the recession as soon as November 2009, when it recorded a tiny but significant growth of 0.9% in the third quarter. Manufacturing too had woken up from hibernation, posting a 7.6% quarter-on-quarter rise. Zuma affirmed that, "By the end of December, we had created more than 480,000 public works opportunities, which is 97% of the target we had set."


South Africa has been on the upward path since its recovery. GDP growth in the fourth quarter of 2009 was 3.2%. But going forward, the authorities have to curb public expenditure growth, which was deliberately fueled to stimulate the economy. The International Monetary Fund (IMF) predicts South Africa's budget deficit for 2009-10 will be 5.7% of the GDP, which might be trimmed with the economy's slow progress.

The country is relying heavily on the upcoming football World Cup that commences on June 11th to bolster the economy with some much needed revenue. Accounting firm



In a nod to South Africa's emergence on the global stage, the country is hosting 2010 football World Cup. Recently, the football world governing body, FIFA, boosted the South African budget for this much awaited event to \$523 million from \$423 million.

Grant Thornton's research reveals that of South Africa's 3% forecasted growth for this year, the World Cup will account for 0.5% and Africa's biggest economy is expected to be richer by around \$12.4 billion at the end of the sports tournament.

South Africa has always been known for its fighting spirit, and the world has witnessed its transformation. Though faced with newer challenges, the country is remaining on course, to navigate from an emerging super power on the continent to an emerging global player in the international markets. In South Africa, it's possible. 

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