

Fresh merger talks to rescue fumbling PPC

AfriSam re-enters fray as boardroom battles over producer's poor performance intensify

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● Since the board's falling out over strategy with its former chief executive Ketso Gordhan about three years ago, the questions of how cement producer PPC is to forge a new path amid an onslaught of domestic competition, and how it is to manage a successful Africa expansion programme, have been foremost in investors' minds.

Given the 70% plunge in its valuation over the past five years, it's a story that hasn't gained much traction.

The past week's axing of CEO Darryll Castle, just two and a half years into his role, has served to further muddy the waters for the company, founded in 1892 as the country's industrialisation ramped up.

It's a tenure during which the ailing producer's shares slumped 74% to R4.45 on his final day at the helm. Over the same period, the JSE All Share rose close to 13%.

The group's gross profit has remained stagnant over the past three years, while return on equity has been steadily decreasing, according to Bloomberg data.

Despite its performance "investors had been starting to take some comfort that PPC would be able to emerge through this chal-

lenging period with the CEO Darryll Castle running the company," Adrian Cloete, a portfolio manager at PSG, said.

Since his departure was announced on Monday, PPC's shares fell to as low as R4, before recovering through the course of the week.

Apart from a sluggish economy in its second recession in eight years, local cement producers have seen their market share fall to international producers such as Dangote Cement, owned by Africa's richest man, Aliko Dangote, and the recently merged entity of LafargeHolcim. The market has also been hit by cheap Asian imports, which have been stemmed but still pose a threat.

But a former board member has singled out Sefhaku Cement – in which Africa's richest man has a 64% stake – as having had the biggest impact on PPC's operations.

These pressures have once more brought a proposal of a merger of equals between PPC and AfriSam, owned by Phuthuma Nhleko vehicle Pembani, to the table.

The fresh attempt to merge the operators seems to cumulate at points of distress for PPC's board and management.

This time it's the departure of Castle, following closely on former Reserve Bank governor Tito Mboweni's decision to quit the 11-member board. It's believed the former governor was unhappy with the board's decision to replace the CEO.

Mboweni referred all questions to the chairman of PPC's board.

At the height of the last boardroom battle in December 2014, PPC received the first merger proposal from the smaller AfriSam.

The offer was rejected because of the smaller rival's high level of debt.



Cement tycoon Aliko Dangote has emerged as the biggest threat to 125-year-old PPC. Picture: Getty Images



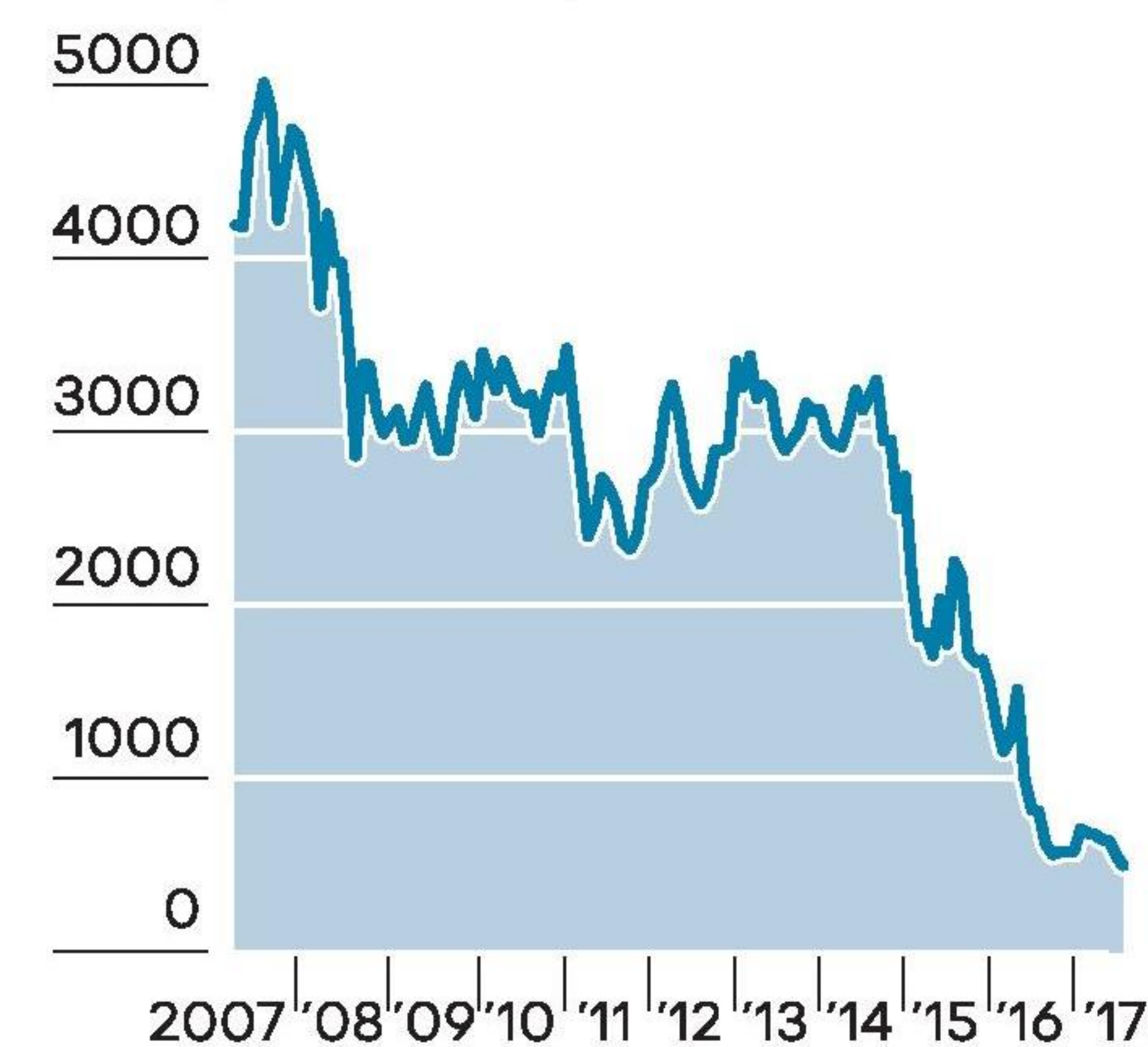
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Peter Takaendesa

Analyst at Mergence Investment Managers

PPC

Share price, monthly close (cents)



Graphic: Ruby-Gay Martin Source: Bloomberg

At the time of the approach, PPC's shares were valued in the region of R16 compared with the R4.69 at which they ended on Friday. The plunging valuation has placed AfriSam in a stronger position with regard to the latest round of talks about a possible tie-up between the two.

An insider indicated that Richard Tomes, the executive for sales and marketing at AfriSam, was tapped to take up the mantle of the merged group. Tomes has been with AfriSam since 2014 and previously worked at PPC for 13 years.

Earlier this month, PPC said formal talks on the potential merger were continuing. The Public Investment Corporation, which owns almost 66% of AfriSam and almost 11% of PPC, is seen as a key supporter of an eventual tie-up.

PPC is in a more precarious position than three years ago, when it had put the deal on ice. New projects in the Democratic Republic of the Congo, Zimbabwe, Ethiopia and Rwanda, which all require funding, have strained the company's balance sheet.

According to analysts, the merged company should have much more scale when completed, but any deal has implementation risks that can dilute the synergistic benefits.

A merged entity is usually inwardly focused in the first few years as management is normally occupied with successfully completing and implementing the merger.

An AfriSam insider said a merger was the only way for either of the groups to survive.

Tinashe Kambadza, equity analyst at Afrifocus Securities, said in a report published earlier this year, the largest competitors on the African continent were LafargeHolcim (50 million tons) and Dangote (40 million tons), while the proposed merger would create an entity with an estimated total capacity of only 16.8 million tons.

PPC has an annual output of 11 million tons and AfriSam 5.8 million tons.

Should the deal be completed, Kambadza noted, the new entity would be more competitive in East Africa.

Peter Takaendesa, analyst at Mergence Investment Managers, said merging the two companies and deciding which assets to take or sell were always going to be difficult tasks because they involved two of the biggest cement companies.

"We have seen some shareholders selling their shares, so maybe we might get a few where they hold on and see what else is going to happen. But it's not a good sign when the CEO steps down like that; it raises a question of, 'What's wrong?'"

Should the deal collapse for the second time in three years and economic conditions remain the same, Takaendesa said, it was likely PPC would have to undertake another rights issue next year and AfriSam would have to follow suit.

Last August, PPC won approval from shareholders to issue additional shares for a planned R4-billion rights issue.

Takaendesa said Dangote, who had been keen on buying PPC before the merger talks with AfriSam began, would probably come back knocking on the cement producer's door as this was an opportunity for it.

A merger could help stabilise unsustainable cement prices, Takaendesa said.