Deloitte Stability Index Africa

H2 FY22 update

July 2023

MAKING AN IMPACT THAT MATTERS since 1845

The Squeeze Scenario

Emerging from the disruptions of the pandemic, many economies in Africa (and around the world) are experiencing levels of inflation not seen since the global financial crisis. Central banks across the continent have responded with a sharp tightening of monetary policy and further rate increases are projected in 2023. Debt and capital markets are tightening.

What do the inflationary and interest rate pressures mean for business? In this edition of the Deloitte Stability Index (DSI), we explore how "The Squeeze Scenario" is impacting the profitability and debt capacity of companies across Africa.

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Unadjusted H2 FY22 results

Deloitte Stability Index

Key takeaway

The Deloitte Stability Index (DSI) measures the extent to which a company is financially stable based on a granular model that converts leading indicators into a composite score. The DSI covers ten jurisdictions across Africa.

Financial ratios used in the DSI:

Trading performance	Debt management	Return on assets	Financial leverage	Interest cover	Altman z-score
Change in revenue over time	*Ability to manage down net debt over time*	*Balance sheet efficiency and productivity*	*Ability to repay debt from profits*	*Ability to service debt*	*Risk of short-term bankruptcy*

Converted into a DSI score via a four-step process:

Ratio analysis
1

The six ratios above are calculated for each listed company in the dataset for the defined time periods.

Scoring
2

Each ratio is assigned a score based on boundaries that have been set.

Aggregation
3

The six ratios are aggregated to form an overall score out of 100, where 100 is the highest level of stability.

Categorisation
4

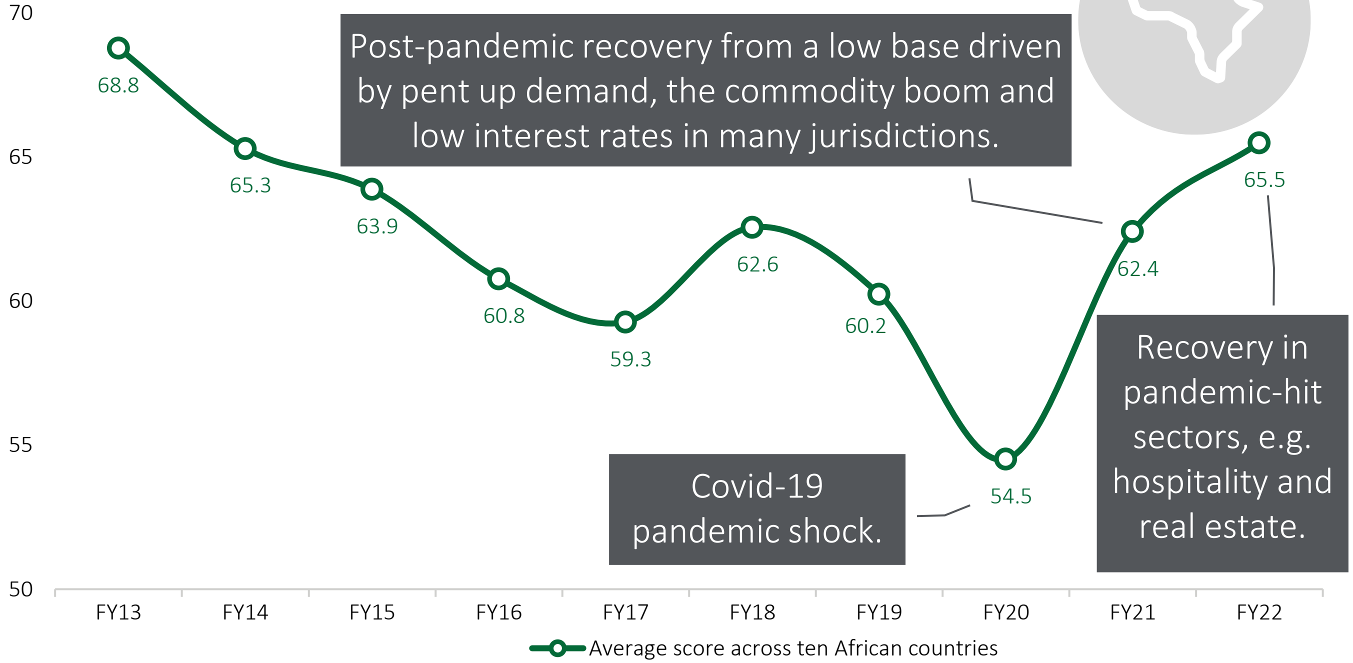
We assign each company a sector classification based on Deloitte's industry taxonomy, and banking relationships are derived from AFS.

Unadjusted FY22 results

Key takeaway

The FY22 DSI shows further gains since the pandemic, but this is due to a “lag effect” as most companies in Africa have yet to report their FY22 results. In other words, the true impact of The Squeeze Scenario is not yet reflected in the unadjusted DSI.

Deloitte Stability Index: Unadjusted (score is stated out of 100)



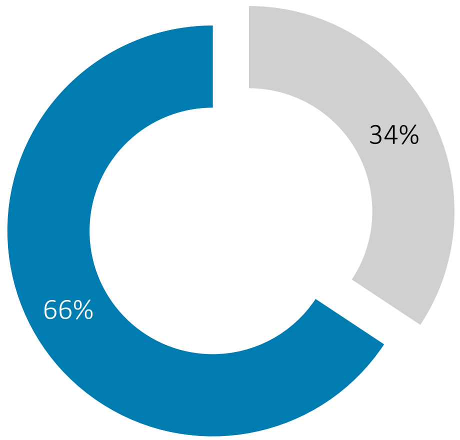
Post-pandemic recovery from a low base driven by pent up demand, the commodity boom and low interest rates in many jurisdictions.

Covid-19 pandemic shock.

Recovery in pandemic-hit sectors, e.g. hospitality and real estate.

Source: Deloitte Stability Index H2 FY22 Africa edition

Companies reporting their FY22 results



🟦 The proportion of listed companies in Africa that have yet to report their FY22 financial information.

The Squeeze Scenario

The **inflation** acceleration

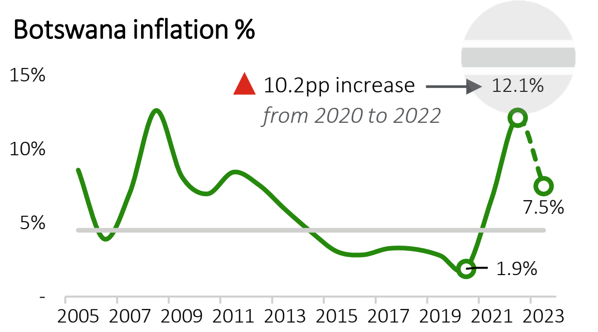
Inflation across many African jurisdictions have reached levels not seen since the global financial crisis.

Key:
- Actual
- Forecast
- Target inflation

Sources: Fitch, World Bank, Bank of Botswana, Bank of Ghana, Central Bank of Kenya, Bank of Namibia, South African Reserve Bank, Bank of Tanzania, Bank of Uganda, Bank of Zambia.

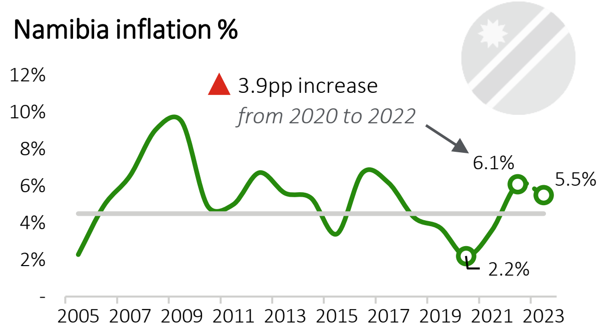
Note: The latest central bank target inflation is charted below. Where a central bank has set a target range, the mid-point is charted.

Botswana inflation %



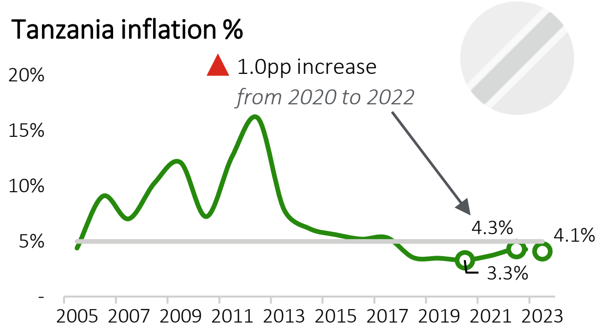
10.2pp increase *from 2020 to 2022*

Namibia inflation %



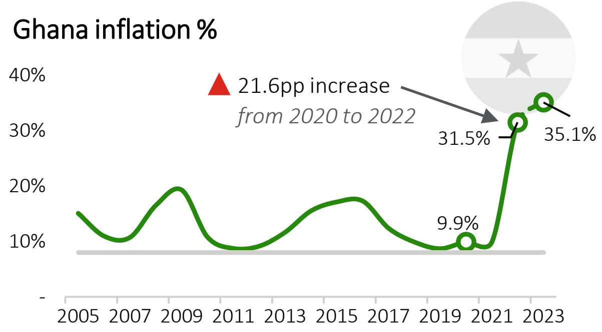
3.9pp increase *from 2020 to 2022*

Tanzania inflation %



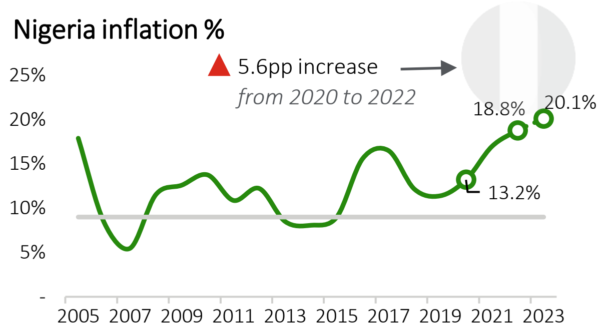
1.0pp increase *from 2020 to 2022*

Ghana inflation %



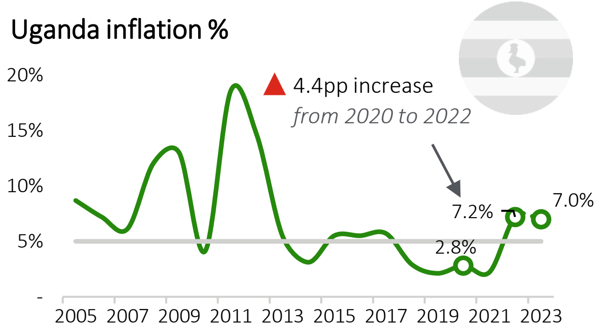
21.6pp increase *from 2020 to 2022*

Nigeria inflation %



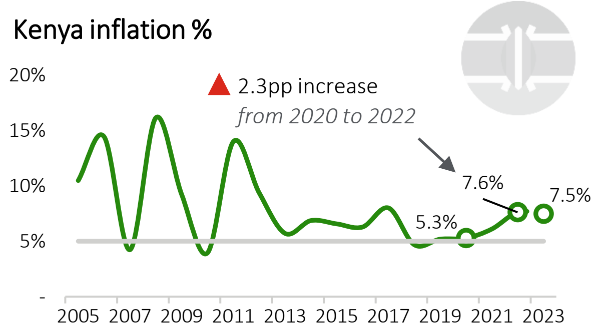
5.6pp increase *from 2020 to 2022*

Uganda inflation %



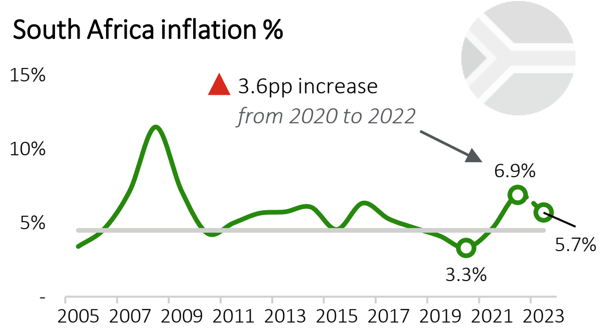
4.4pp increase *from 2020 to 2022*

Kenya inflation %



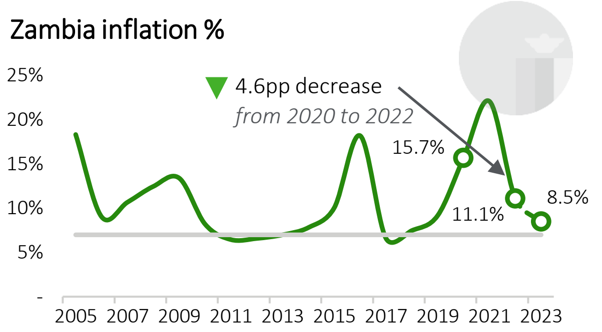
2.3pp increase *from 2020 to 2022*

South Africa inflation %



3.6pp increase *from 2020 to 2022*

Zambia inflation %



4.6pp decrease *from 2020 to 2022*

The **interest rate** handbrake

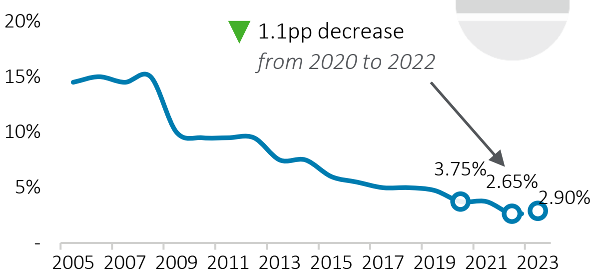
Most central banks have responded with a sharp tightening of monetary policy.

Key:

— Policy rates

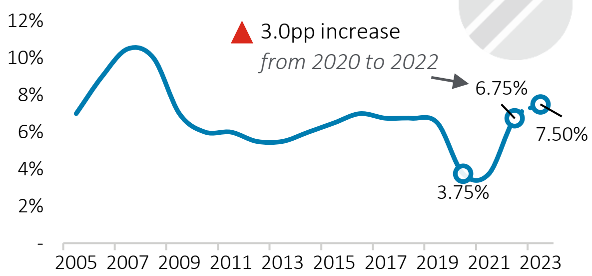
Sources: Fitch, World Bank, Bank of Botswana, Bank of Ghana, Central Bank of Kenya, Bank of Namibia, South African Reserve Bank, Bank of Tanzania, Bank of Uganda, Bank of Zambia.

Botswana policy interest rate %



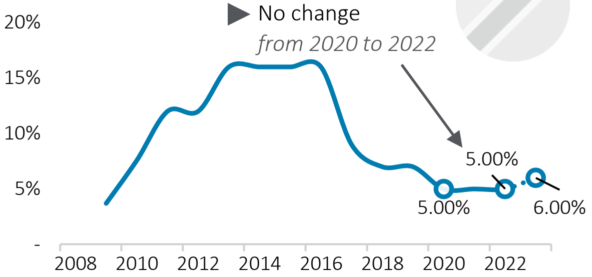
▼ 1.1pp decrease *from 2020 to 2022*

Namibia policy interest rate %



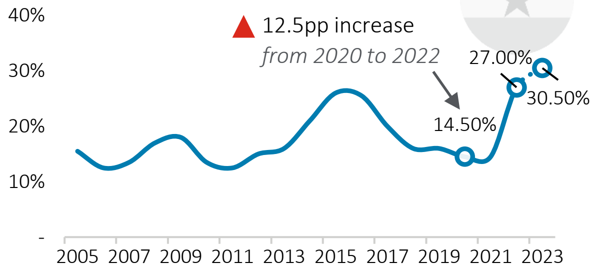
▲ 3.0pp increase *from 2020 to 2022*

Tanzania policy interest rate %



▶ No change *from 2020 to 2022*

Ghana policy interest rate %

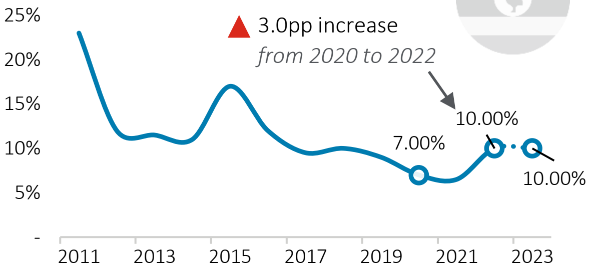


▲ 12.5pp increase *from 2020 to 2022*

Nigeria policy interest rate %

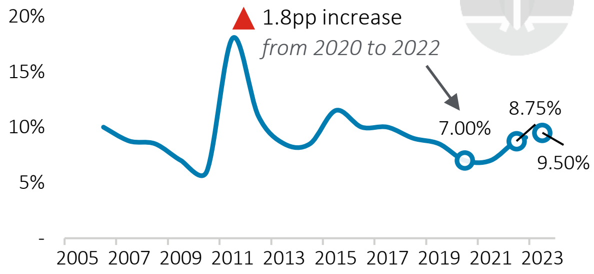
▲ 5.0pp increase *from 2020 to 2022*

Uganda policy interest rate %



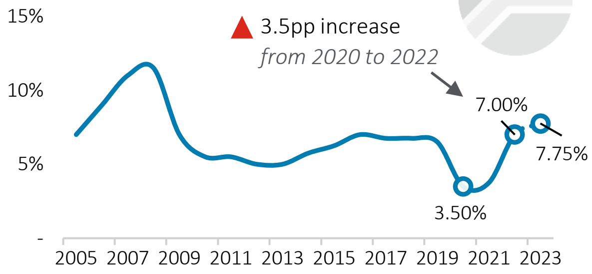
▲ 3.0pp increase *from 2020 to 2022*

Kenya policy interest rate %



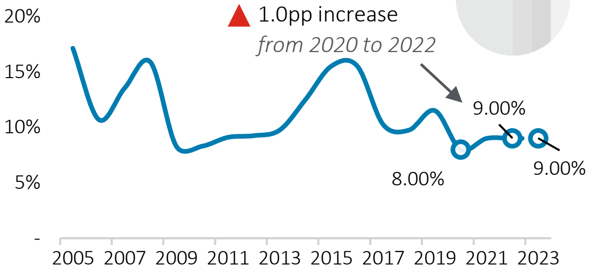
▲ 1.8pp increase *from 2020 to 2022*

South Africa policy interest rate %



▲ 3.5pp increase *from 2020 to 2022*

Zambia policy interest rate %



▲ 1.0pp increase *from 2020 to 2022*

We have run four basic sensitivities on the latest DSI period across Africa:

01 Applied the 2022 inflation rate for each market to costs (to “catch” up to current realities).

02 Applied the 2023 inflation rate for each market to costs (to reflect forward-looking risk).

03 Assumed 50% of the inflationary increase in costs can be passed on to cost-conscious consumers.

04 Debt servicing costs, assumed to be variable, follow the policy rate (2022 and 2023 forecast).

…together, these sensitivities comprise the “Squeeze Scenario”

The Squeeze Scenario

What do inflationary and interest rate pressures mean for business? We have run the four sensitivities opposite in the DSI to illustratively simulate the conditions businesses across Africa will be facing.

The table below provides an illustrative example of how the latest reported income statement has been amended in the model:

“Company A” *(illustration only)*

KES’000s	Base case	Squeeze Scenario	*Variance*
Revenue	50 000	53 775	*3 775*
Cost of sales	(40 000)	(46 040)	*(6 040)*
Gross Profit	**10 000**	**7 735**	***(2 265)***
Overheads	(3 800)	(4 374)	*(574)*
EBITDA	**6 200**	**3 361**	***(2 839)***
Depreciation & Amortisation	(500)	(500)	-
Interest	(700)	(950)	*(250)*
PBT	**5 000**	**1 911**	***(3 089)***

Squeeze Scenario assumptions
(Sensitivities applied against the base case)

- **50% of the increase** in costs is **passed on to customers** through increased prices
- Assume **cost of sales increase** by **15.1%** (i.e. 2022 & 2023 Kenyan inflation rates)
- Assume **overheads increase** by **15.1%** (i.e. 2022 & 2023 Kenyan inflation rates)
- Assuming no change in debt, **interest expense increases** by **2.50%** (assume variable rate)

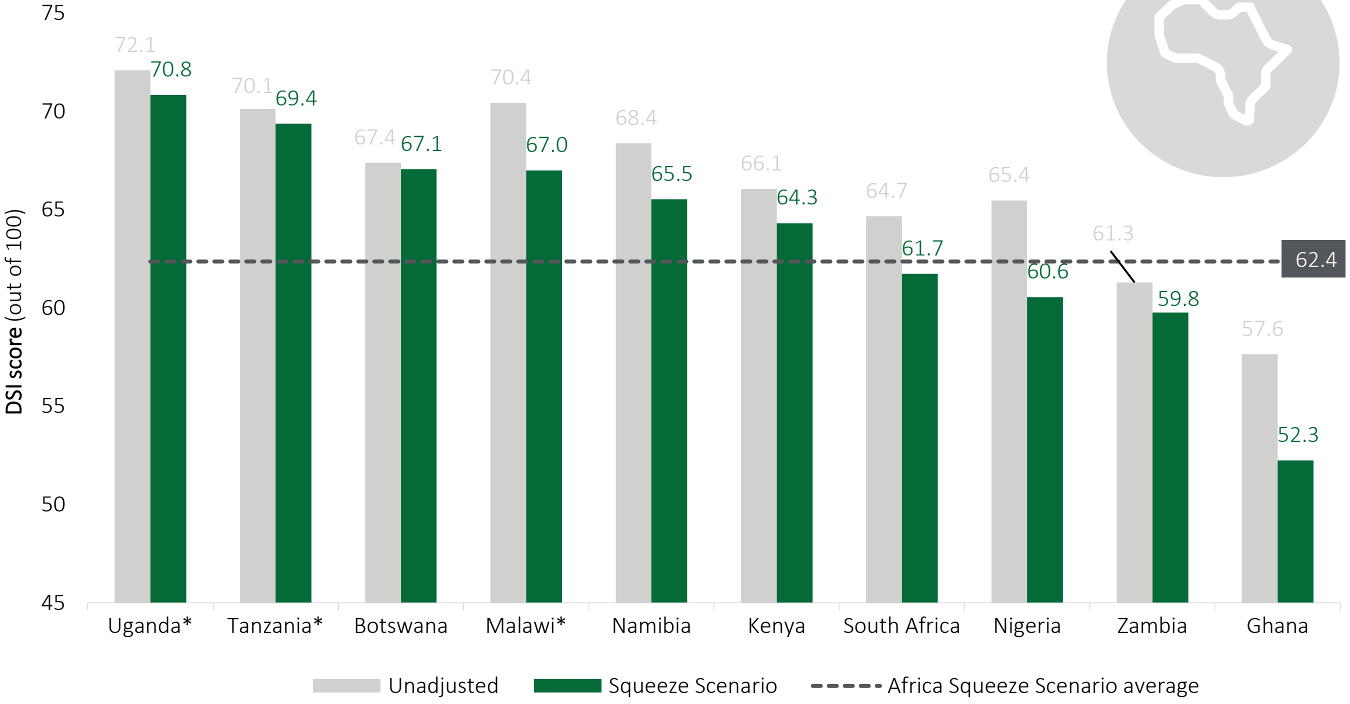
Squeeze Scenario results

Squeeze Scenario FY22 results

Key takeaway

Runaway inflation and historically high interest rates in Ghana and Nigeria mean the Squeeze Scenario is felt most in these jurisdictions. South Africa’s sensitivity to the Squeeze Scenario is largely driven by retail, real estate and construction.

Deloitte Stability Index: Unadjusted vs Squeeze Scenario



Source: Deloitte Stability Index H2 FY22 Africa edition

Key assumptions and limitations

- The “Squeeze Scenario”, whilst intended to mirror real world trends, is a *ceteris paribus* hypothetical illustration only. These dynamics will not apply to all companies equally. Factors such as price elasticity, the intensity of competition and flexibility in the cost base will be important considerations when assessing specific companies.
- DSI data is based on publicly available information for listed companies in Anglophone sub-Saharan Africa as reported on Capital IQ. The jurisdictions covered are: (i) Botswana, (ii) Ghana, (iii) Kenya, (iv) Malawi, (v) Namibia, (vi) Nigeria, (vii) South Africa, (viii) Tanzania, (ix) Uganda, and (x) Zambia. We have not sought to audit, verify or reconcile this data to original annual financial statements.
- The countries indicated with an asterisk (*) have stock exchanges with fewer than 20 listed companies, which are generally dominated by multinational companies with local listings (e.g. MTN, Vodacom and Stanbic). As a result, the average DSI score for these countries appears higher than local macroeconomic conditions would indicate.
- Detailed DSI information is available on request.

Profits under pressure

Key takeaway

High inflation and interest rates may put highly geared sectors such as power and real estate under strain, while margin-pressured sectors such as healthcare and hospitality could also feel the pinch.

Source: Deloitte Stability Index H2 FY22 Africa edition

Key:
- 🔴 Interest cover DSI score declines by 30% or more
- 🟠 Interest cover DSI score declines by 20% - 29%
- 🟢 Interest cover DSI score declines by less than 20%

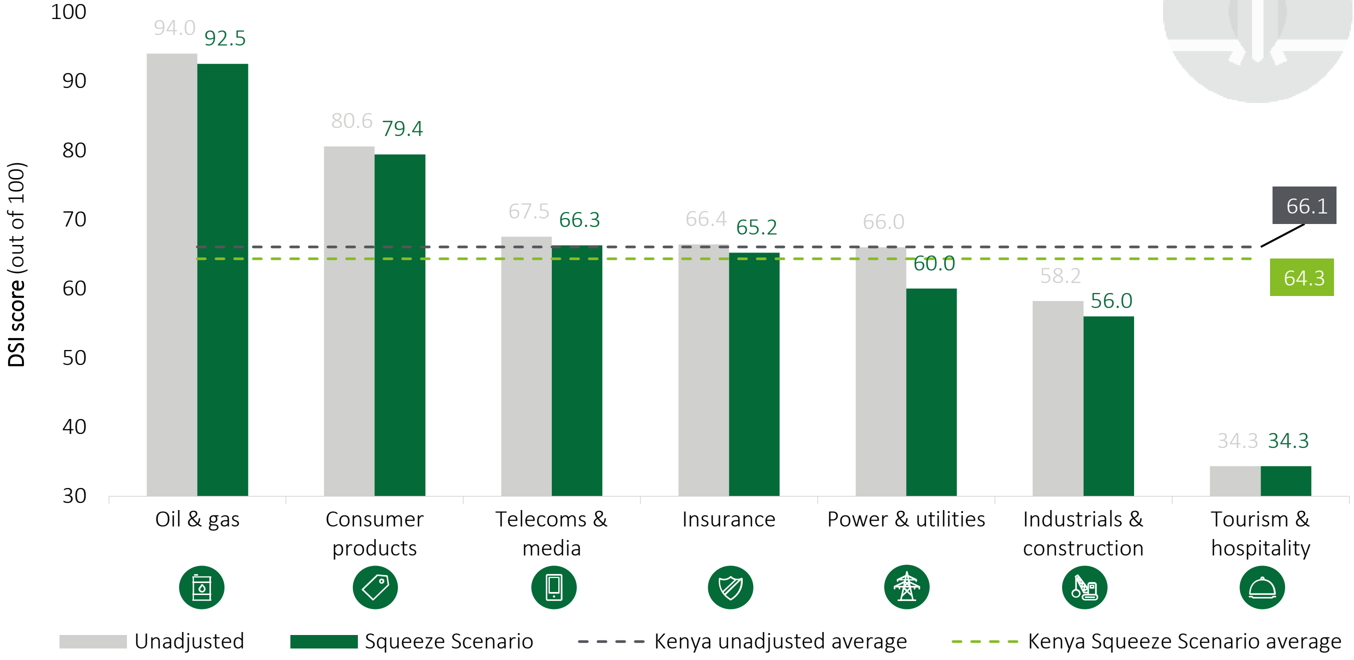
Sector *(Africa-wide)*	No. of companies	Average **interest cover** score *(out of 20)*			Risk rating
		Squeeze Scenario		Unadjusted	
Healthcare	5	3.7	*39% decline*	6.0	🔴
Power & utilities	8	4.6	*34% decline*	7.0	🔴
Real estate	38	5.0	*34% decline*	7.6	🔴
Tourism & hospitality	30	5.5	*24% decline*	7.3	🟠
Automotive	5	5.6	*36% decline*	8.8	🔴
Mining & metals	24	7.4	*9% decline*	8.1	🟢
Technology	23	7.8	*13% decline*	9.0	🟢
Retail	35	8.1	*26% decline*	10.9	🟠
Industrials & construction	37	8.2	*21% decline*	10.4	🟠
Oil & gas	31	8.5	*25% decline*	11.3	🟠
Consumer products	59	8.5	*18% decline*	10.3	🟢
Telecoms & media	29	9.1	*17% decline*	10.9	🟢
Life sciences	9	9.3	*16% decline*	11.1	🟢
Insurance	26	9.9	*15% decline*	11.7	🟢

The view from Kenya:
Squeeze Scenario FY22 results

Key takeaway

Inflation and interest rates are reaching heights last seen in the aftermath of the 2016 drought; this has an outsized impact on highly geared sectors such as power & utilities and industrials & construction. Meanwhile, cost of living crises abroad have kept tourism & hospitality demand weak.

Deloitte Stability Index: Unadjusted vs Squeeze Scenario



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- Detailed DSI information is available on request.

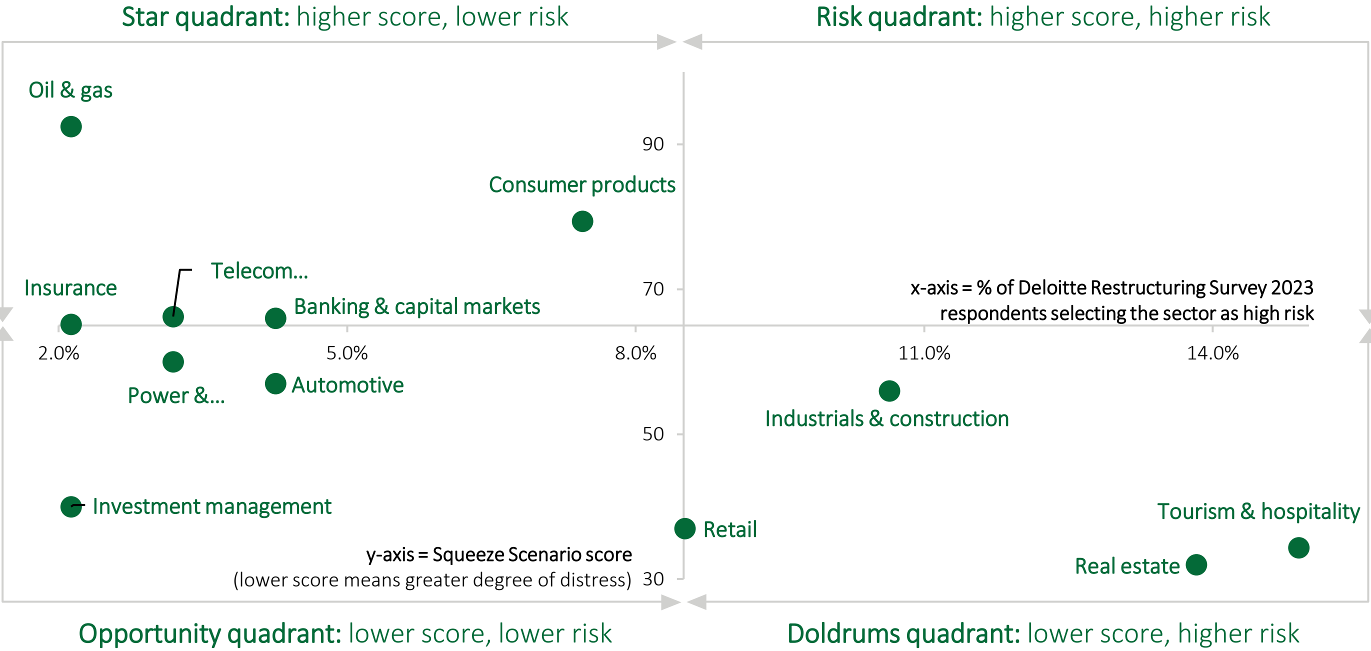
The view from Kenya:

Sectors at risk

Key takeaway

The construction, real estate and tourism sectors have yet to recover from the pandemic, and are expected to remain in the doldrums in 2023. Distress in retail and consumer products is emerging; this is likely to be accelerated by the tax hikes contained in the finance act voted in during June 2023.

Average Deloitte Stability Index score per sector ↑ vs % of Deloitte Restructuring Survey respondents selecting the sector as high risk →



Source: Deloitte Stability Index H2 FY22 Africa edition, Deloitte Restructuring Survey 2023 results

Chart explainer

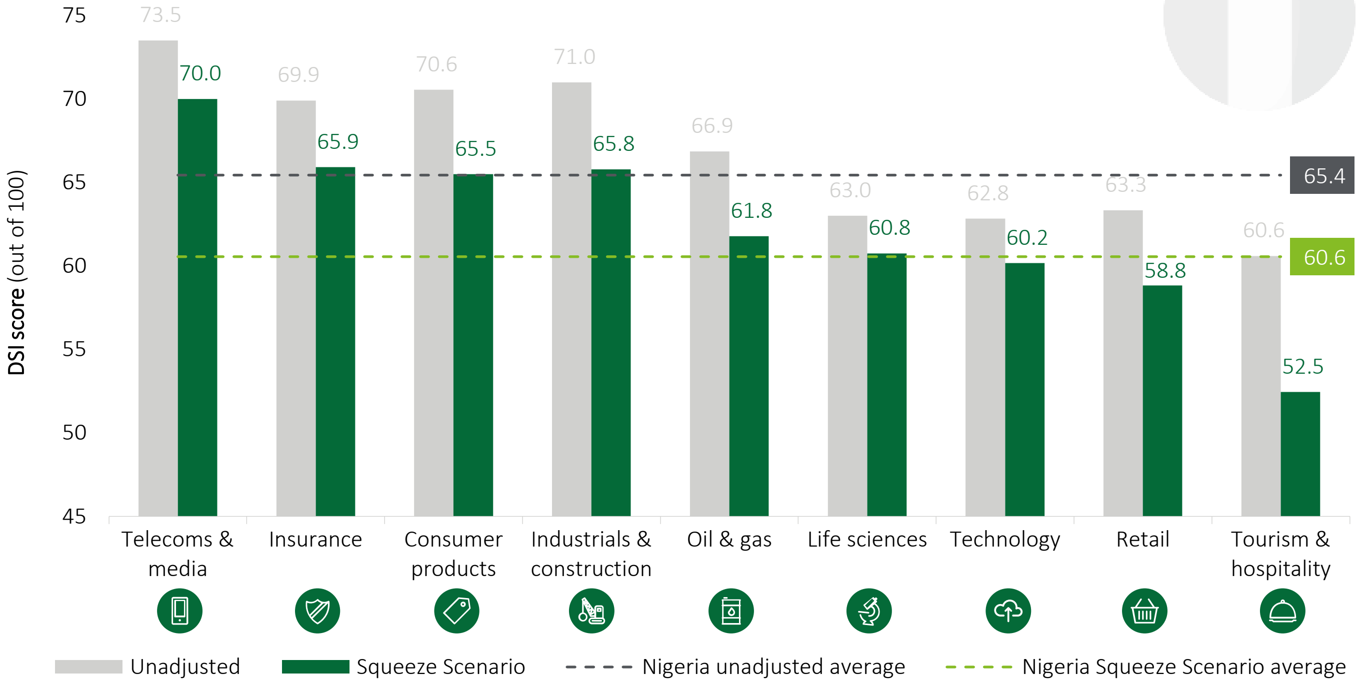
- As part of the *Deloitte Restructuring Survey 2023*, 150 restructuring professionals and C-Suite executives across Kenya, Nigeria and South Africa were asked which sectors they consider to be at risk in 2023.
- The percentages along the x-axis represents the frequency with which a particular sector was selected as being at risk. The further to the right a sector appears, the higher its perceived risk in 2023.
- The survey was conducted between 11 January and 10 February 2023.
- The y-axis represents the Squeeze Scenario DSI score in this H2 FY22 edition.

The view from Nigeria:
Squeeze Scenario FY22 results

Runaway inflation and historically high interest rates in Nigeria are felt most in the tourism & hospitality, retail, and consumer products sectors where already narrow margins could be further eroded.

Key takeaway

Deloitte Stability Index: Unadjusted vs Squeeze Scenario



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- Detailed DSI information is available on request.

The view from Nigeria:
Sectors at risk

Key takeaway

The instability caused by inflation, fuel shortages and queues for currency at banks has led to an acute cost-of-living crisis in Nigeria. It is no wonder, then, that the sectors at risk are those exposed to consumers: retail, consumer products and tourism.

Key:

- 🔴 Interest cover DSI score declines by 35% or more
- 🟠 Interest cover DSI score declines by 25% - 34%
- 🟢 Interest cover DSI score declines by less than 25%

Sector *(Nigeria)*	No. of companies	Average **interest cover** score *(out of 20)*			Risk rating
		Squeeze Scenario		Unadjusted	
Insurance	11	9.4	*19% decline*	11.6	🟢
Telecoms & media	4	8.5	*19% decline*	10.5	🟢
Oil & gas	14	6.5	*32% decline*	9.6	🟠
Industrials & construction	9	6.4	*33% decline*	9.5	🟠
Retail	6	6.3	*31% decline*	9.0	🟠
Life sciences	4	7.5	*17% decline*	9.0	🟢
Consumer products	18	5.6	*36% decline*	8.8	🔴
Technology	6	6.0	*22% decline*	7.7	🟢
Tourism & hospitality	10	3.5	*50% decline*	6.9	🔴

Please note that we have not used forward-looking sector predictions from the 2023 Deloitte Restructuring Survey as the respondent population from Nigeria was not sufficient to draw conclusions.

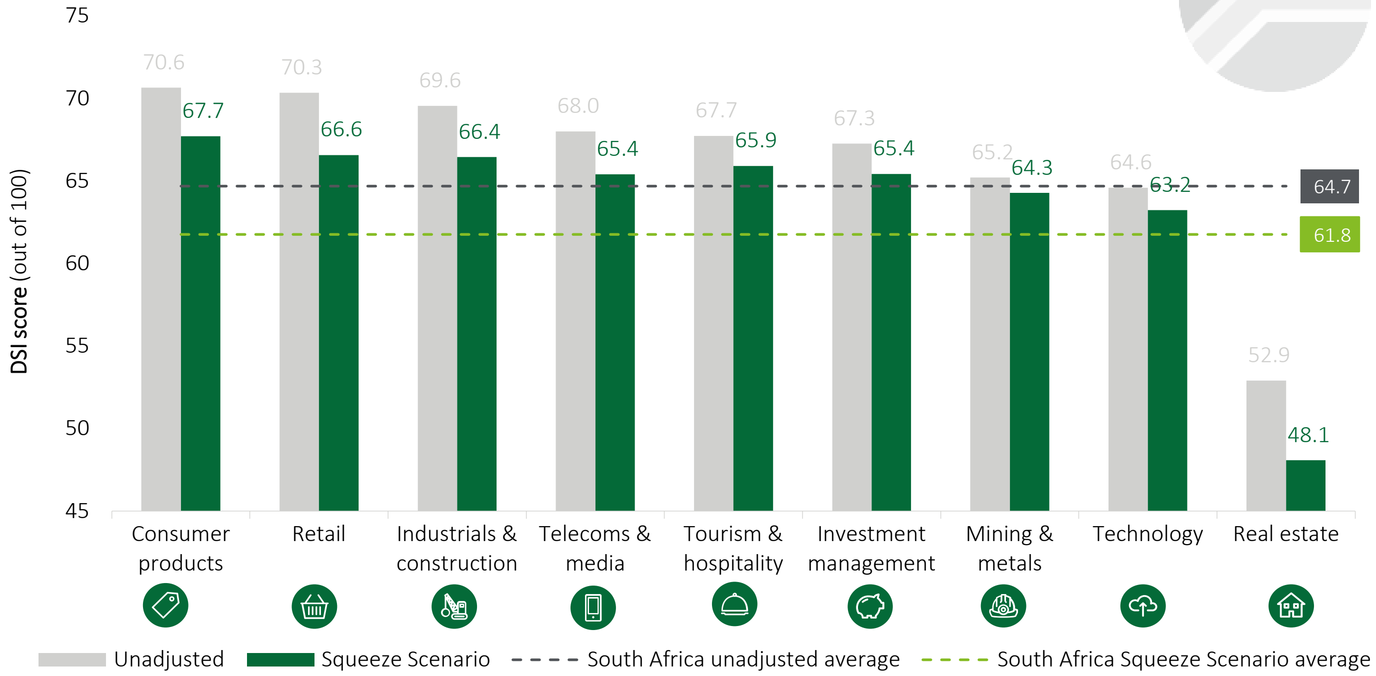
Source: Deloitte Stability Index H2 FY22 Africa edition

The view from South Africa:
Squeeze Scenario FY22 results

Key takeaway

June 2023 saw consumer confidence in South Africa reach its second-lowest point since democracy. When the drivers behind this, inflationary pressure and rising interest rates, are modelled in the Squeeze Scenario, it is unsurprisingly consumer-focused sectors that show the greatest sensitivity.

Deloitte Stability Index: Unadjusted vs Squeeze Scenario



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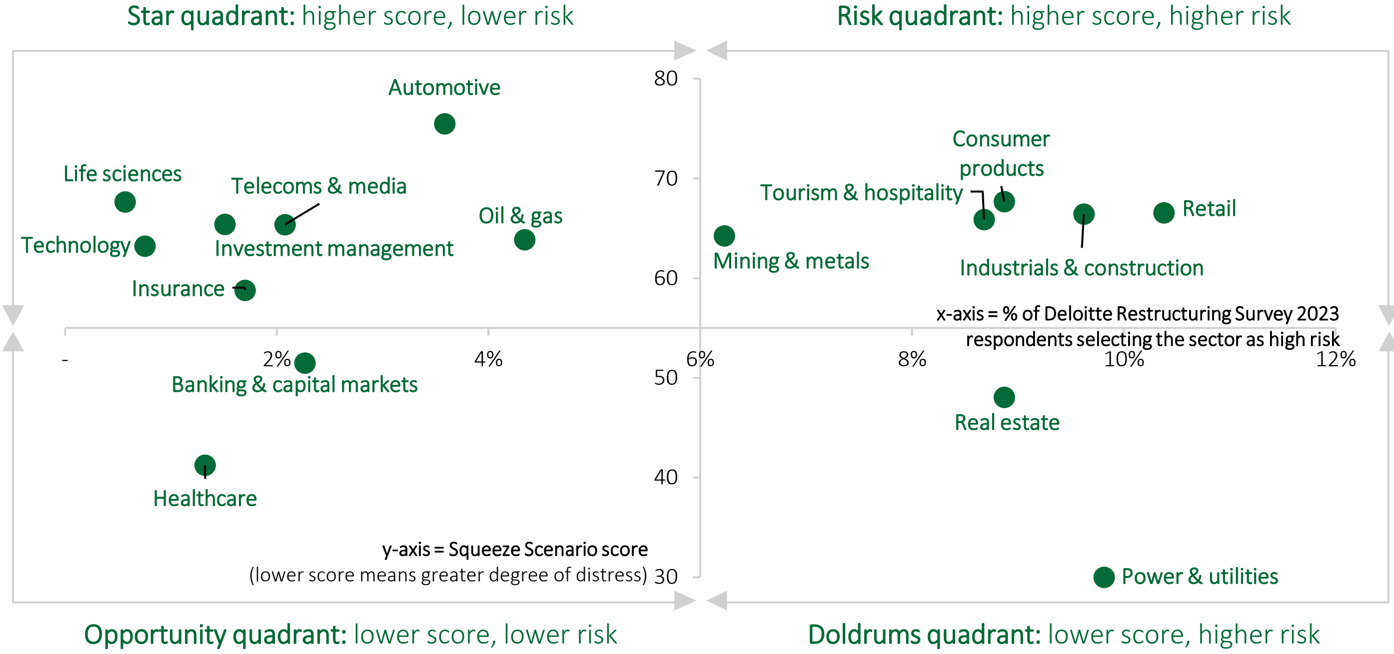
- Detailed DSI information is available on request.

The view from South Africa:
Sectors at risk

Key takeaway

Tightening household budgets and rapidly changing consumer preferences make retail and consumer products companies amongst the most at risk, and with them related sectors such as real estate and construction.

Average Deloitte Stability Index score per sector ↑ vs % of Deloitte Restructuring Survey respondents selecting the sector as high risk →



Source: Deloitte Stability Index H2 FY22 Africa edition, Deloitte Restructuring Survey 2023 results

Chart explainer

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Defensive strategies

2023 outlook

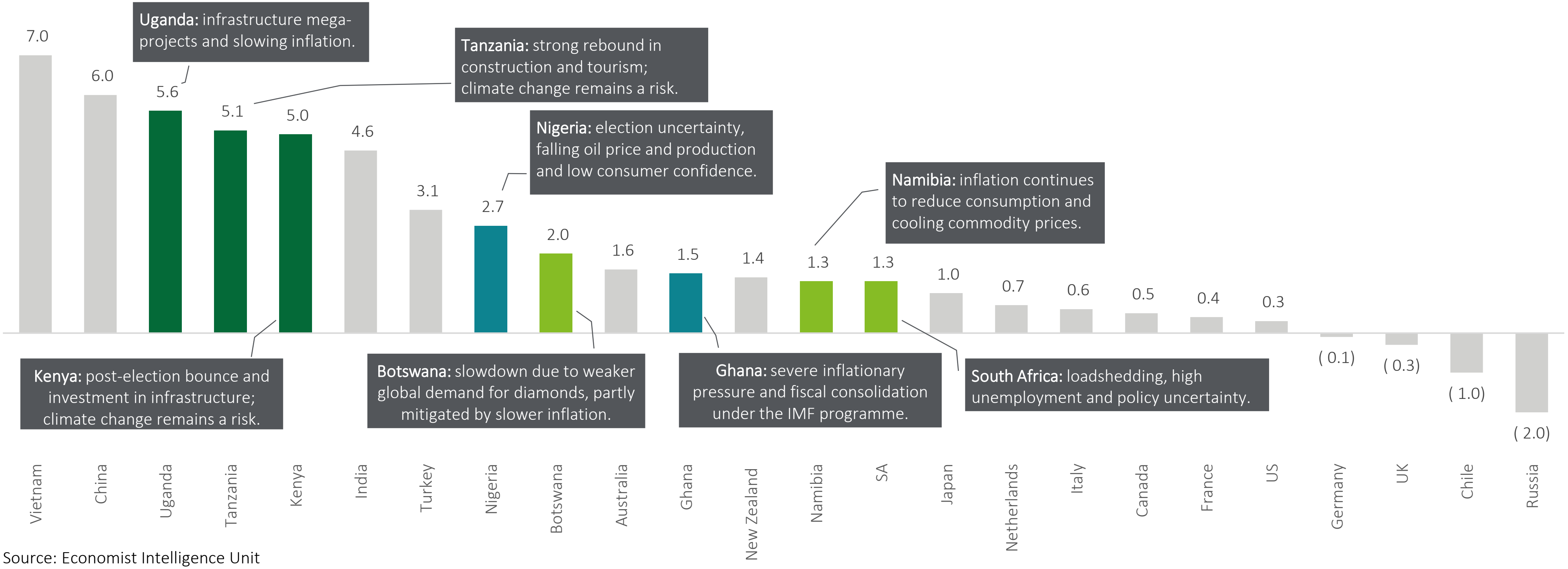
Key takeaway

Southern and West Africa economies are forecast to remain in the doldrums alongside most G7 economies due to global stagflation fears and acute local crises (loadshedding, oil etc). East Africa is expected to buck this trend.

Key:

🟩 East Africa
🟩 Southern Africa
⬜ International
🟦 West Africa

2023 GDP outlook (% change in real GDP)



Uganda: infrastructure mega-projects and slowing inflation.

Tanzania: strong rebound in construction and tourism; climate change remains a risk.

Nigeria: election uncertainty, falling oil price and production and low consumer confidence.

Namibia: inflation continues to reduce consumption and cooling commodity prices.

Kenya: post-election bounce and investment in infrastructure; climate change remains a risk.

Botswana: slowdown due to weaker global demand for diamonds, partly mitigated by slower inflation.

Ghana: severe inflationary pressure and fiscal consolidation under the IMF programme.

South Africa: loadshedding, high unemployment and policy uncertainty.

Source: Economist Intelligence Unit

Business sentiment

Key takeaway

CFOs are prioritising defensive strategies, such as cost reduction, cash flow management and deleveraging to mitigate against an uncertain economic environment.

Key:

🟩 Q4 2022

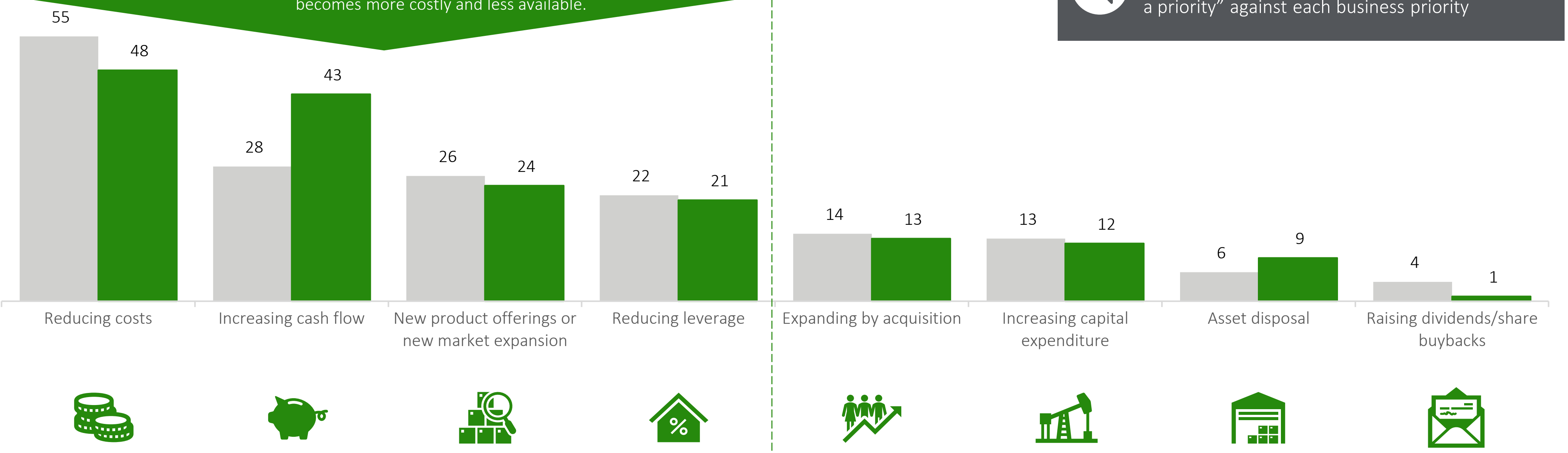
⬜ Q3 2022

CFO Priorities | Q4 2022 Deloitte Survey Results

% of CFOs who rate each of the following as a strong priority for their business in the next 12 months

CFOs have indicated that their key business priorities in 2023 will be increasing profitability, releasing cash/improving liquidity, and reducing overall debt as credit becomes more costly and less available.

Survey response: CFOs had to indicate either "strong priority", "somewhat of a priority" or "not a priority" against each business priority



Source: Deloitte CFO Survey Q4 2022

Countering the "Squeeze Scenario"

Astute businesses are making countermoves now to mitigate against the "Squeeze Scenario".

Key takeaway

	Challenges	Impact	Countermoves
Inflationary pressure	• Record-high inflation in 2022 has resulted in increased input and overhead costs.	• Margins are getting squeezed, and more cash is required to sustain business operations.	• Review pricing strategy and test elasticity in line with market and competitive advantage. • Seek alternate sources of supply.
Increased borrowing costs	• Central banks are raising interest rates to counter inflationary pressures.	• Increasing debt servicing costs will decrease consumer spending and capital expansion and drag on leveraged business cash flows.	• Identify and implement deleveraging strategies • If in doubt, engage lenders early and reschedule servicing to match cash flows.
Working capital	• Margin erosion and dampened demand resulting in slower moving inventory. • Receivables becoming stretched.	• If unaddressed this may lead to short-term cash flow challenges.	• Set up a working capital PMO and Identify opportunities for 'quick wins' cash release. • Include working capital cost in project / customer financial assessments.
Portfolio assessment	• The pandemic and geo-political tensions have caused financial and operational stress across many industries and value chains.	• There is an opportunity for businesses to re-evaluate their business portfolio / non-core assets or look for distressed M&A opportunities.	• Accelerate 'fix, sell or close' decisions and act fast to resolve underperformance. • Scan for targets with potential synergies.
Supply chain disruptions	• Global supply chain pressures have contributed to inflation, but these pressures were easing in 2022.	• In some cases, disruptions resulted in increased input prices or a complete halt in production due to shortages.	• Map out supply chains and ascertain ability of suppliers to fulfil orders.

Our Africa-wide team

Our Africa Turnaround & Restructuring services

Stakeholder engagement and management

are at the heart of our approach and are key to the successful outcomes we deliver.

Performance Improvement

Creating and implementing initiatives to release cash trapped in working capital and aligning costs with strategic priorities.

Common Information Platform

Providing one version of the truth for decision-making and negotiations, e.g., through business reviews or building cash flow models.

Restructuring Office

Holistic turnaround and balance sheet restructuring of stressed businesses, setting a firm foundation for the future.

Restructuring Implementation

Rehabilitating businesses and realising recoveries for stakeholders by taking insolvency appointments and supporting appointment takers.

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