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Deloitte Stability Index Africa

FY23 update

October 2024

MAKING AN IMPACT THAT MATTERS since 1845

Report contents

Africa’s cost crunch

For the first time since the pandemic, the Deloitte Stability Index (DSI) shows that companies are experiencing increased signs of distress. The culprit for this is volatile input costs – whether due to inflation, weakening local currency, or supply chain challenges – and cash-strapped customers are more and more resistant to bearing the brunt through price increases.

In this edition of the DSI, we explore the impact of Africa’s “cost crunch”, with a particular focus on South Africa and Nigeria, and how companies can better manage their bottom line.

FY23 results overview

Deloitte Stability Index (DSI)

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
Change in revenue over time

Debt management
Ability to manage down net debt over time

Return on assets
Balance sheet efficiency and productivity

Financial leverage
Ability to repay debt from profits

Interest cover
Ability to service debt

Altman z-score
Risk of short-term bankruptcy

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

01

Ratio Analysis

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

02

Scoring

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

03

Aggregation

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

04

Categorisation

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

DSI as an early warning system

The output below shows an example of how the DSI can be used to create a monitoring dashboard for stakeholders.

GBL

Example Deloitte Stability Index dashboard for clients of Generic Bank Limited

Early stage watchlist criteria:

- **01** Declining trend for past three periods
- **02** Underperforming vs sector average
- **03** FY23 score between 40 and 70

Late stage watchlist criteria:

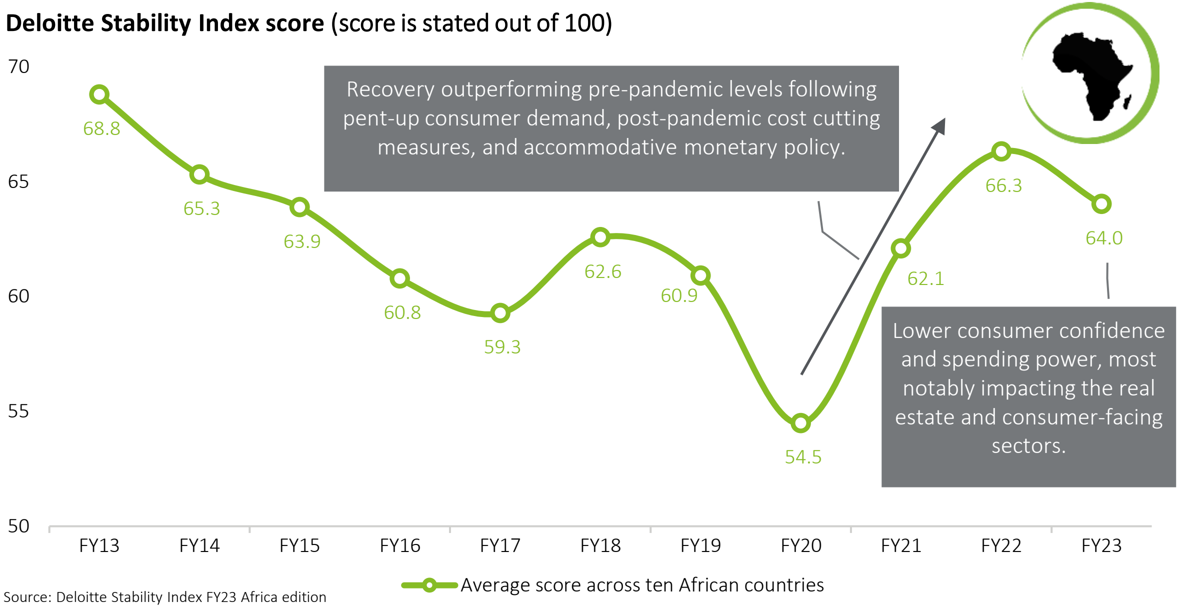
- **04** FY23 score below 40

Company name	Sector	Deloitte Stability Index score (out of 100)				
		FY20	FY21	FY22	FY23	Risk rating
Early stage watchlist						
Brewing Company Plc	Consumer products	32	39	42	53	
Professional Services Inc	Technology	92	74	69	55	
Chemical Brothers Ltd	Oil, gas & chemicals	58	60	68	60	
Chocolate Producers Plc	Consumer products	90	70	69	67	
Flour Millers Inc	Consumer products	46	44	41	69	
Late stage watchlist						
InsuranceCo Plc	Insurance	19	21	25	26	
Oil Company Ltd	Oil, gas & chemicals	10	13	21	28	
African Insurance Inc	Insurance	55	94	37	38	
Phone Manufacturer Plc	Telecoms & media	37	15	37	39	
Pharmacies Plc	Consumer products	40	48	57	39	

Africa FY23 results: Overview

For the first time since the Covid-19 pandemic, the overall DSI score has declined. The key driver for this across most countries is reduced consumer spending power and companies struggling to pass on volatile input costs.

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



Source: Deloitte Stability Index FY23 Africa edition

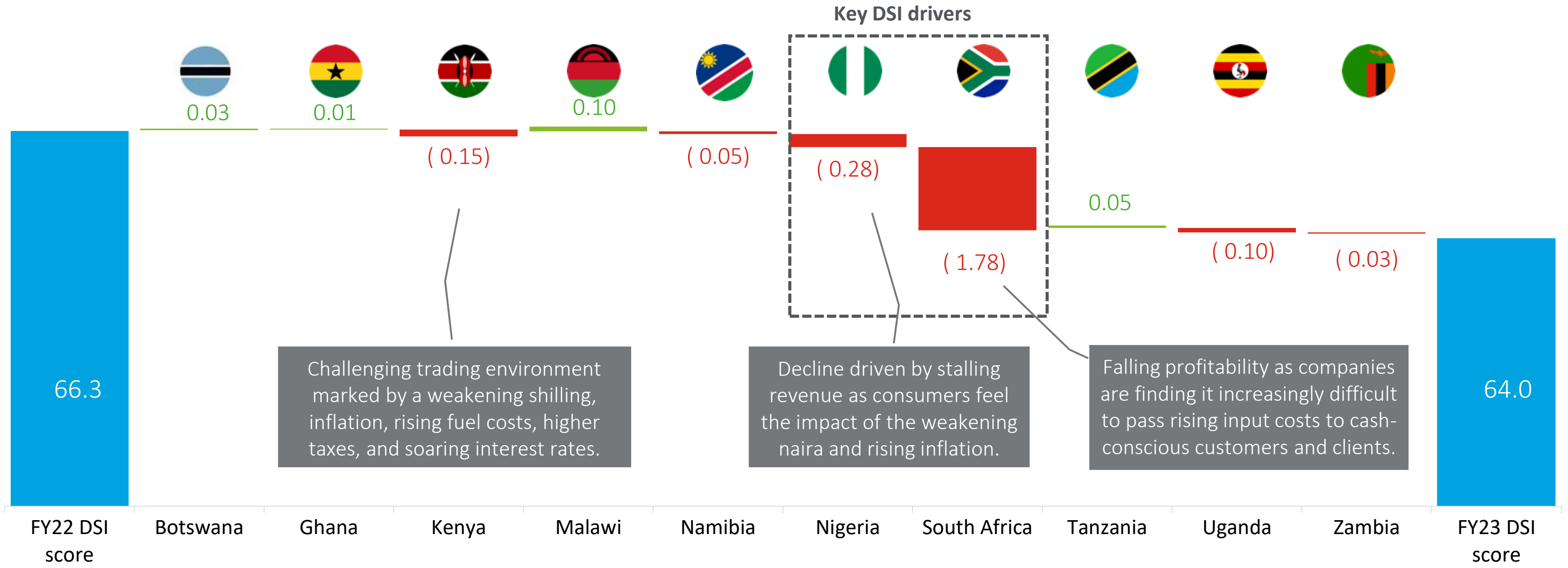
Key assumptions and limitations

- DSI data is based on publicly available information for listed companies as reported on Capital IQ for the following jurisdictions: (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.
- We have refreshed the underlying information from FY19 to FY22, which results in a change in the DSI score for companies that have either reported late or restated past results compared to previous DSI editions.
- Detailed DSI information is available on request.

Africa FY23 results: Trends in countries driving the score

In this year's edition, we will focus on **South Africa** and **Nigeria** as these were the countries driving the overall decline in the DSI score.

Country bridge chart (FY22 to FY23 DSI score)



Source: Deloitte Stability Index FY23 Africa edition

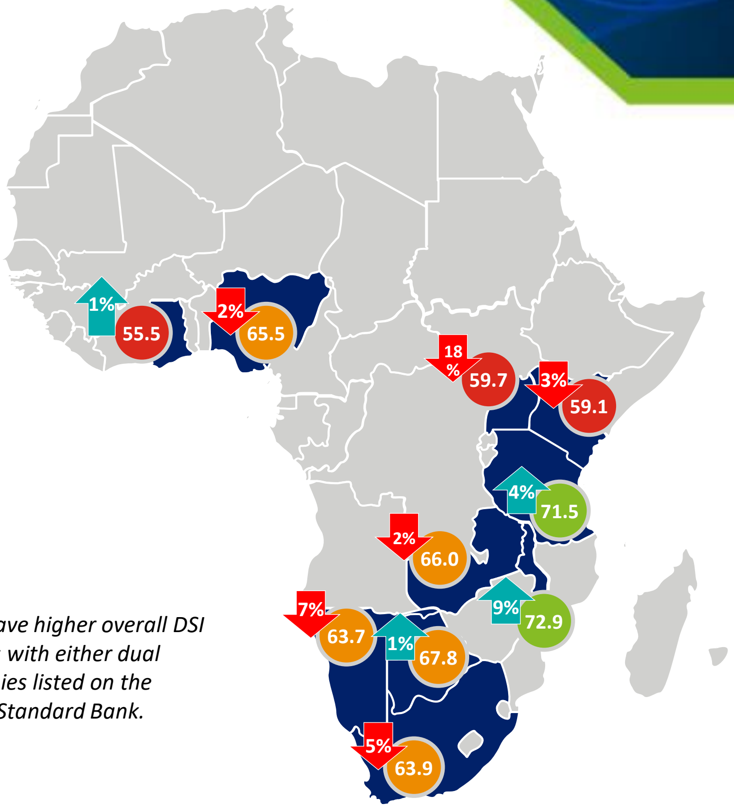
Africa FY23 results: DSI score by country

DSI score by country

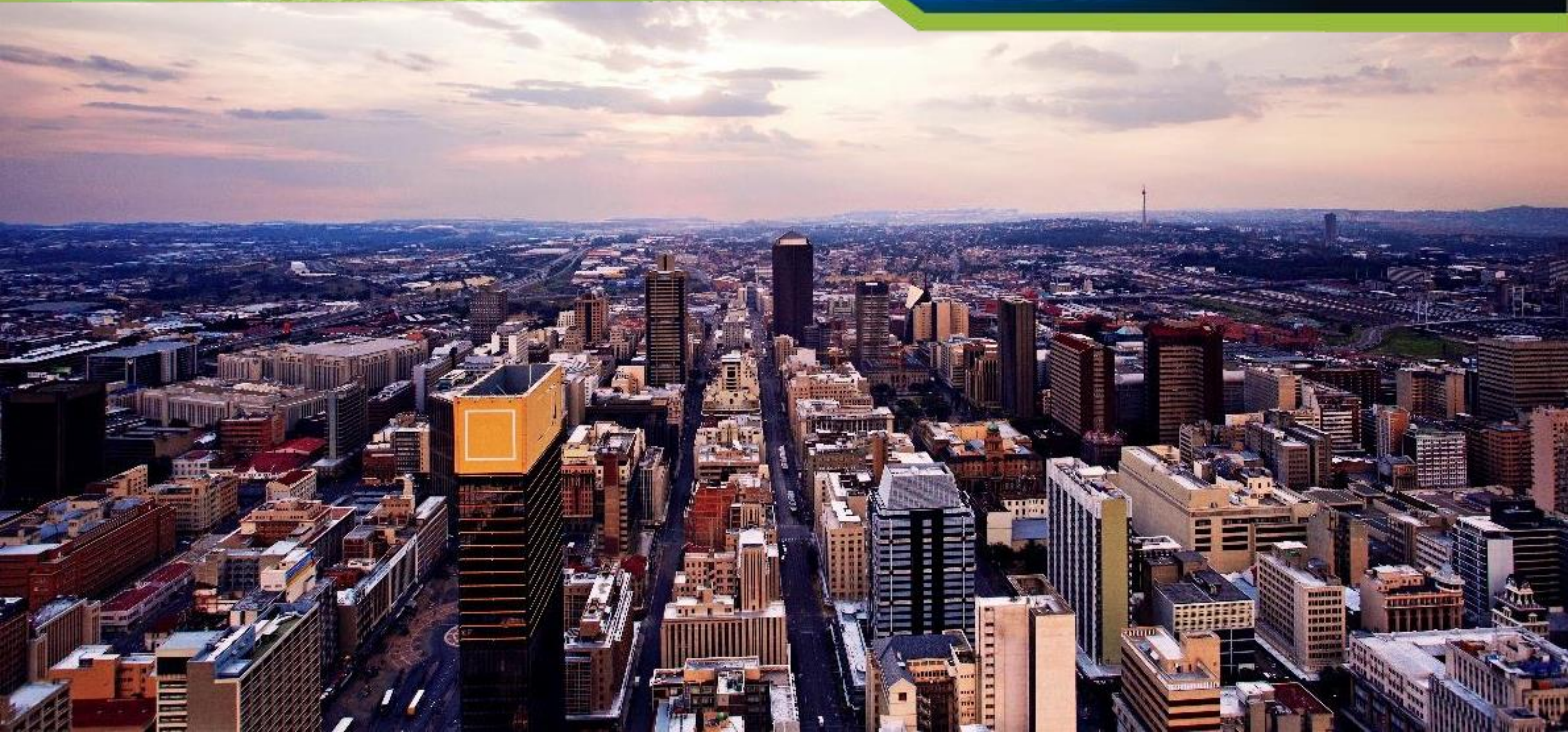
Key:

- Increase in score from FY22
- Decrease in score from FY22
- Average score greater than 70
- Average score 60 – 70
- Average score less than 60

N.B. Smaller stock exchanges, e.g. Malawi, tend to have higher overall DSI scores as these are dominated by multinational firms with either dual listings or a local ListCo. For example, the 16 companies listed on the Malawian exchange include Airtel, Illovo Sugar, and Standard Bank.



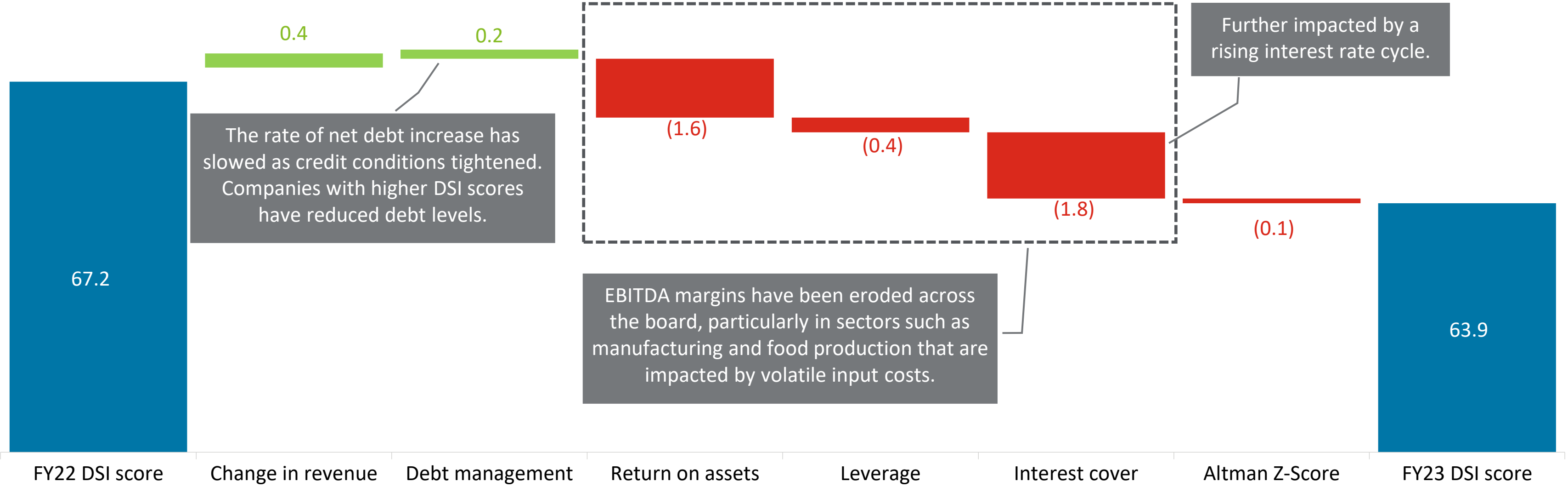
South Africa's cost crunch



South Africa DSI score drivers

The South African DSI score has fallen for the first time since the pandemic, driven by eroding profitability in sectors reliant on commodity inputs (e.g. manufacturing) and consumer-facing sectors (e.g. retail) where already-thin margins have been squeezed further.

South Africa FY22 to FY23 DSI score: drivers by metric

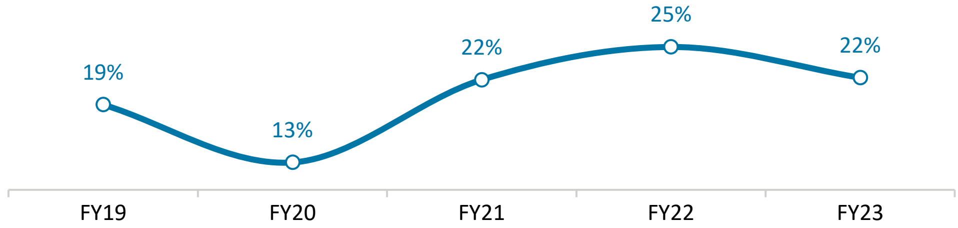


Source: Deloitte Stability Index FY23 Africa edition

South Africa's cost crunch

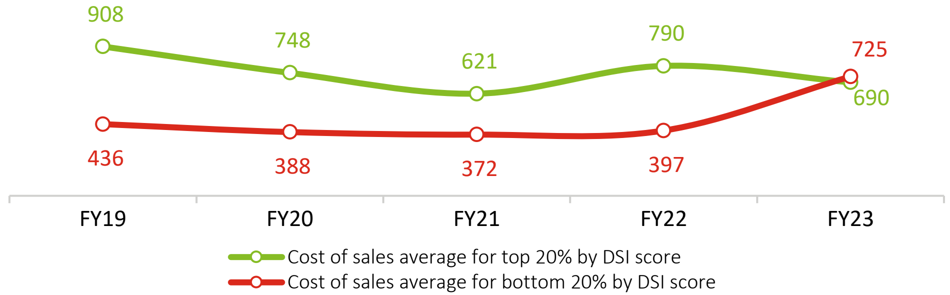
While overall average profitability has declined, the impact of rising costs is felt most keenly by companies with a lower DSI score. This disparity is not sector-specific. It may instead reflect qualitative factors such as the calibre of management and strength of board oversight.

Average EBITDA margin for South African companies (%)



Source: Deloitte Stability Index FY23 Africa edition

Average cost of sales across companies with the top / bottom 20% DSI scores (USD'm)



Source: Deloitte Stability Index FY23 Africa edition

Lower pressure on costs and margins

- Mining & metals
- Technology
- Manufacturing & construction
- Consumer products
- Retail

Higher pressure on costs and margins

- Real estate
- Mining & metals
- Oil, gas & chemicals
- Consumer products
- Manufacturing & construction

Coloured text = sector represented in the top and bottom five

Effectively managing the bottom line (1/2)

As outlined on the previous two pages, the key cause of the overall DSI score reduction in South Africa is rising costs and a reduced scope to pass cost increases to the customer. However, companies with a higher DSI score seem better able to keep costs down. This effect cannot be explained by sector-specific trends as the DSI shows this divergence also occurs within sectors.

So, what accounts for this widening gap between stronger and weaker companies? We believe the answer lies in the quality of board oversight. The graphs below from our *2024 Deloitte Restructuring Survey* show that the C-Suite wants to prioritise cost management initiatives but may be encountering resistance from boards who do not share the same priorities.

C-Suite ranking of levers to maximise shareholder value

1	Working capital optimisation
2	Cost reduction
3	Investment in technology
4	Sell non-core assets
5	Geographic expansion
6	Pursue strategic acquisitions
7	Sustainability and ESG

Key: = defensive levers = expansionary levers

Source: Deloitte Restructuring Survey 2024 results | Respondents: All regions, C-Suite and lenders only

What is the relative importance of the following areas to your board's agenda?

Source: Deloitte Restructuring Survey 2024 results | Respondents: All regions, C-Suite only

Effectively managing the bottom line (2/2)

In our experience, it is crucial that the board understands the importance of effective cost management initiatives, that there is executive-level sponsorship, and accountability against tangible targets.

Board buy-in

The board approves the process, and a sub-committee of the board has oversight of the cost management initiatives.

Executive sponsorship

At least one C-Suite level executive, who reports directly to the CEO and board subcommittee, is responsible for the cost management initiatives.

Capacity and capability

Experienced employees are temporarily reassigned to focus on delivery of the cost management initiatives, bolstered by temporary professional help where required.

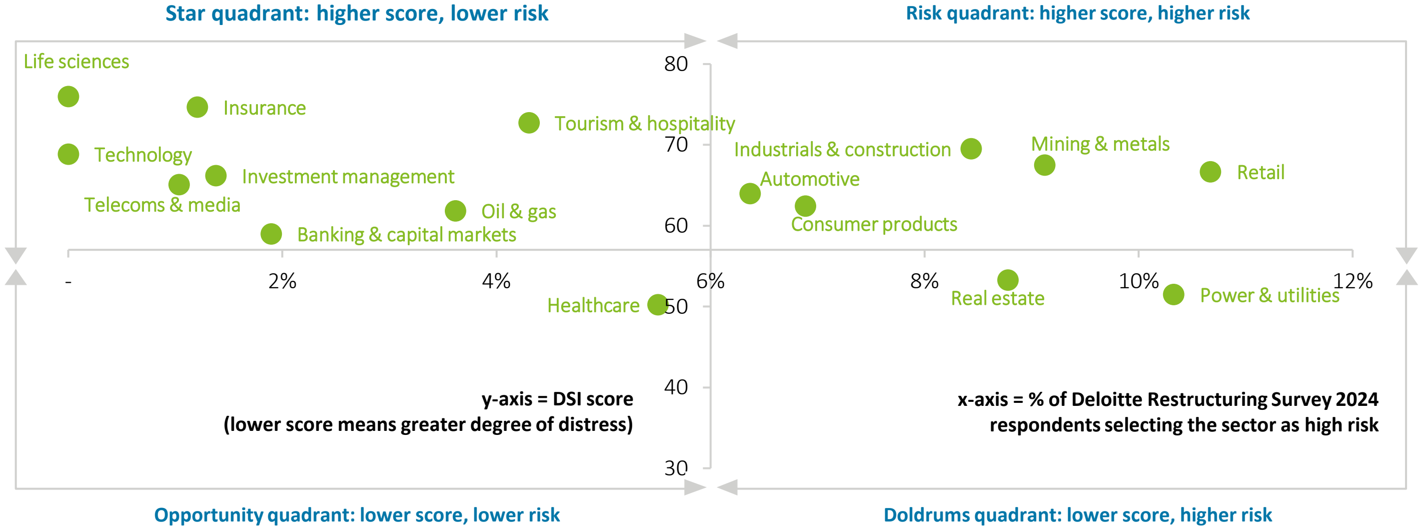
Monitoring

Tangible milestones and KPIs are set, which are reported regularly to executive management and the board.

Sectors at risk

Retail and consumer products remain in the high-risk quadrant due to stubbornly low consumer confidence, while the cost crunch has impacted sectors such as mining, industrials 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 FY23 Africa edition, Deloitte Restructuring Survey 2024 results

Chart explainer

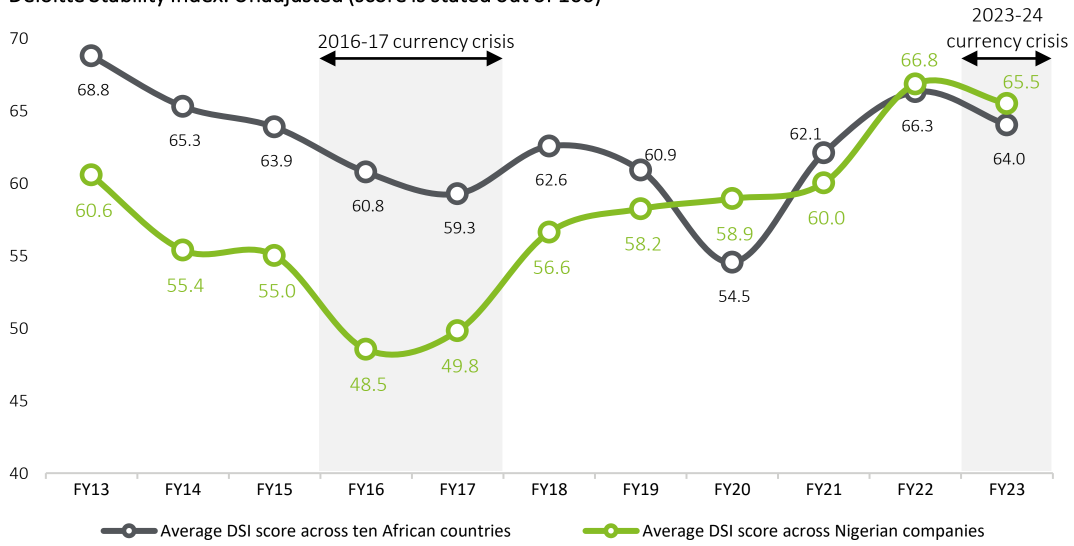
- As part of the Deloitte Restructuring Survey 2024, 213 restructuring professionals and C-Suite executives across Kenya, Ghana, Nigeria and South Africa were asked which sectors they consider to be at risk in 2024.
- The percentages along the x-axis represents the frequency with which a particular sector was selected as being at risk. The further to the right a sector appears, the higher its perceived risk in 2024.
- The survey was conducted between 11 January and 09 February 2024.
- The y-axis represents the FY23 DSI score.

Nigeria’s currency crisis

Nigeria unadjusted FY23 results

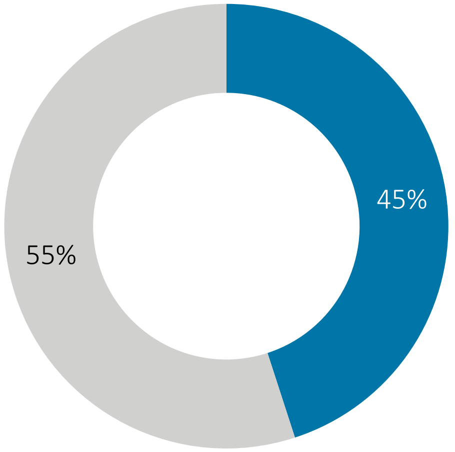
FY23 saw a downward trend in the DSI as consumer spending came under pressure, most notably due to the rapidly weakening Naira. However, many companies, particularly those reporting in the second half of 2023, have yet to release results. This means that the true impact of the 2023-24 currency crisis is not yet reflected in the unadjusted DSI.

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



Source: Deloitte Stability Index FY23 Africa edition

Companies reporting their FY23 results

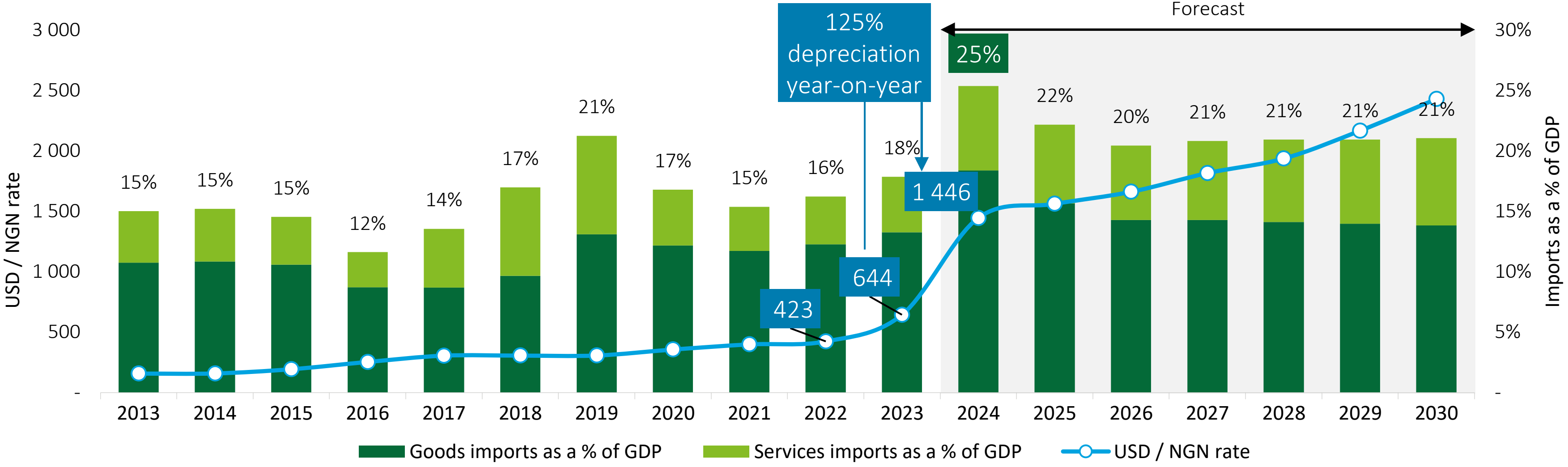


The proportion of listed companies in Nigeria that have yet to report their FY23 financial information.

Consumers under pressure (1/2)

The naira sharply depreciated over the past 18 months in reaction to policy announcements, dollar scarcity, and forex policy reform uncertainty – and forecasts from the Economist Intelligence Unit (see below) suggest this trend is likely to continue. This, in turn, has contributed to increased imported inflation at a time when reliance on imports has been at its highest for the past ten years.

Official USD / NGN exchange rate vs imports as a % of GDP



Source: Economist Intelligence Unit, Fitch

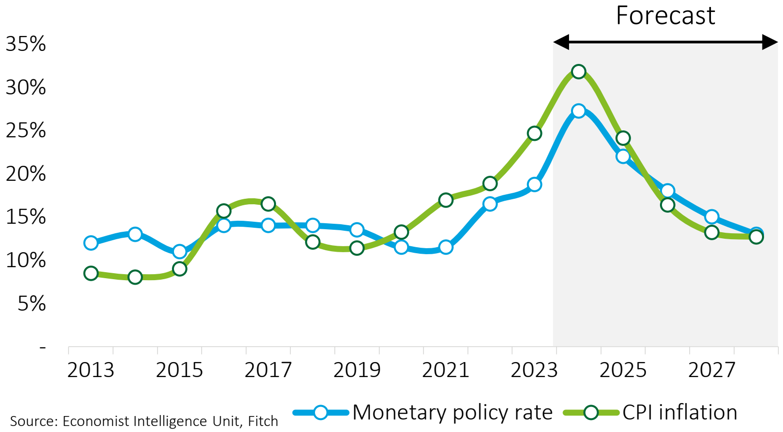
Consumers under pressure (2/2)

Government reforms such as the deregulation of fuel prices and floating of the naira are necessary and arguably overdue for long-term economic growth. The short-term impact, however, has been felt by consumers who have grappled with a volatile naira, rising interest rates, and spiralling inflation.

These factors have contributed to the exit of several multinationals (e.g. GSK, Diageo, P&G) from the Nigerian market, who take with them jobs and investment.

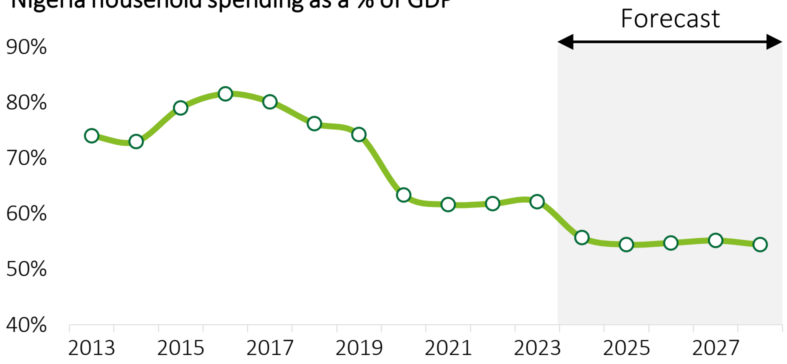
Looking ahead, consumer spending is forecast to continue its downward trajectory, underpinned by a weak naira. We explore the illustrative impact of this trend on the DSI overleaf.

Nigeria monetary policy indicators



Source: Economist Intelligence Unit, Fitch

Nigeria household spending as a % of GDP



Source: Fitch

The FX Scenario

What does the sharp depreciation of the naira mean for businesses in Nigeria? We have run the FX Scenario in the DSI to illustratively simulate the conditions businesses across Nigeria will be facing.

We have simulated the impact of the recent depreciation of the naira on the latest DSI period as follows:

01 Identified the depreciation of the naira from 2022 to 2024, estimated at 125%[1].

02 Identified the extent of reliance on imports, using imports as a % of GDP of 25% in 2024[1] as a proxy.

03 Assumed that 25% of costs are imported, and increased these by 125%, i.e. a 31% FX adjustment factor.

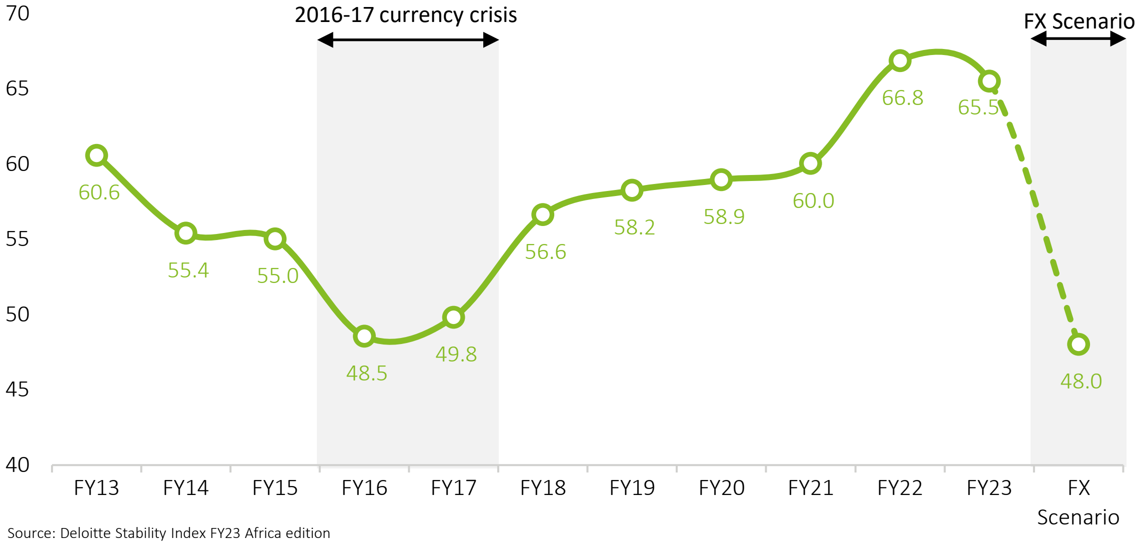
04 Applied the 31% FX adjustment factor to the profitability metrics in the DSI.

[1] See page 17 for sources.

Nigeria FX Scenario results

Companies in Nigeria are particularly sensitive to currency-related increases in their cost base, particularly if this cannot be passed onto cash-strapped consumers. This is reflected in the FX Scenario results, where the DSI score illustratively returns to levels last seen in the 2016-17 currency crisis.

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



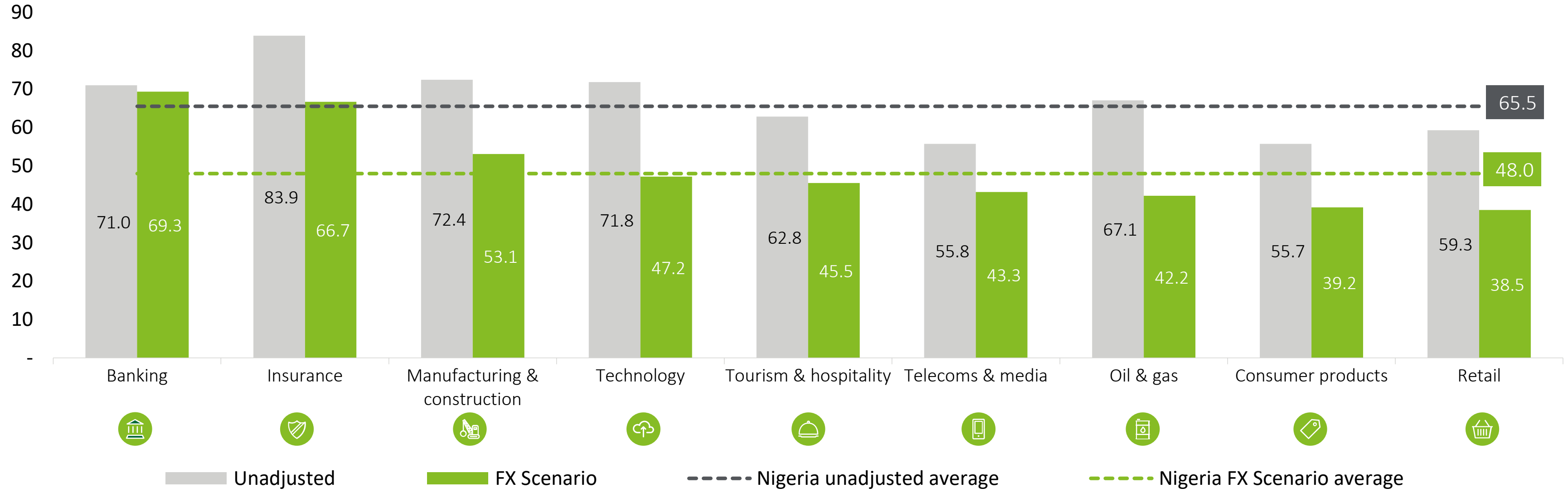
The "FX Scenario", whilst intended to mirror real world trends, is a ceteris paribus hypothetical illustration only. These dynamics will <u>not</u> apply to all companies equally. Factors such as price elasticity, the intensity of competition and flexibility in the cost base will be important considerations when assessing specific companies.

Source: Deloitte Stability Index FY23 Africa edition

Nigeria FX Scenario results

Sensitivity to the FX Scenario is largely driven by consumer-facing sectors such as consumer products and retail that are already facing thin margins. High fixed cost industries that rely on debt funding, such as oil & gas, are also vulnerable.

Unadjusted vs FX Scenario DSI score (out of 100)



Source: Deloitte Stability Index FY23 Africa edition

Our African 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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