**CCRED POLICY BRIEF**

# Industrial Development Research Programme: Metals, machinery and equipment sector[1]

**July 2017**

## Overview

South Africa has in the recent decades gone through a process of deindustrialisation. The contribution of manufacturing to GDP dropped from 20% in 1994 to 14% in 2008, and 12% in 2016. It is within this context and the current policy direction towards growing the manufacturing sector, that this study assesses the investments of the large listed firms in the metals, machinery and equipment (MME) sector, one of the most important industrial sectors. These investments are assessed with a view to understanding company strategies in order to inform the development of appropriate levers and incentives to spur reindustrialisation.

The study analysed the investments made by 25 large listed firms in the MME sector from 2011 to 2016, considering key performance metrics, the nature and location of investments, and the rationale for these investments given by the companies.[2] The companies reviewed in this study are involved in various activities ranging from casting of metals and basic metals production, to the manufacture of intermediate and final products used in a number of sectors including energy, agriculture, mining, construction, automotive, transport, forestry and engineering.

Lead firms in the sector are largely holding companies wherein a single company has a number of subsidiaries involved in the production of various products. Some of the holding firms have limited involvement in the actual operation of the firms. The companies are also characterised by a number of distributorship agreements in which the firm may have sole distributorship rights for international brands in South Africa and within southern Africa. In an already concentrated sector, this raises barriers to entry and the market power of the large, diversified firms.

Three main cross-cutting observations arise from the analysis. The **first** is that there are a significant number of mergers and acquisitions, and consolidation in the sector in the period considered. Based on the available data, there is a relatively even split between mergers taking place within South Africa and those involving acquisitions of companies outside of Africa. A very low proportion involved transactions

[1] This policy brief draws from an underlying working paper forming part of the Industrial Development Research Programme (IDRP) funded by the DTI. See Bell et al. (2017), 'Growth and Strategies of large and lead firms - Metals, machinery and equipment sector assessment', CCRED Working Paper No. 18/2017.

[2] The 25 firms considered include: Accentuate Ltd, Alaris Holdings Ltd, Allied Electronics Corp A, Ansys Ltd, ARB Holdings Ltd, ArcelorMittal SA Ltd, Bell Equipment Ltd, BSI Steel Ltd, Cafca Ltd, Cons Infrastructure Group Ltd, Distribution and Warehousing, Ellies Holdings Ltd, enX Group Ltd, Howden Africa Holdings Ltd, Hulamin Ltd, Insimbi Ref & Alloy Sup, Invicta Holdings Ltd, Kaydav Group Ltd, Labat Africa Ltd, Master Drilling Group Ltd, Mazor Group Ltd, Metair Investments Ltd, PSV Holdings Ltd, Reunert Ltd and South Ocean Holdings Ltd.

within southern Africa or the rest of the continent (excluding South Africa).

The **second** theme is that there are 'pockets of excellence' where firms are investing in developing capabilities and technologies that can drive development and industrialisation. This marks an important area for policy consideration, whereby measures to support continued investment and upgrading of capabilities would be of significant value in terms of enabling the companies to sustain operations. Notably, the handful of firms involved in product development stood out in terms of profitability and growth in operations compared to other companies.

**Third**, firms continue to face challenges in terms of sustaining their operations in the context of low investment, downstream demand (including a decline in government projects), and a challenging cost environment which can limit further growth.

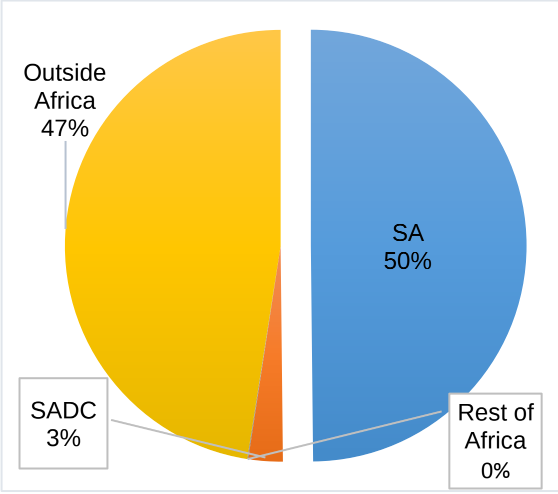
### Mergers and acquisitions

In terms of the value of mergers and acquisitions between 2011 and 2016, approximately 50% of the value of transactions was spent within South Africa, 3% in the SADC region while 47% was spent outside of Africa (Figure 1). The large-scale investments outside South Africa may point to a challenging environment domestically for firms, as discussed above. While some mergers and acquisitions are taking place within the continent, firms have seemingly found profitable opportunities to expand their scope of operations internationally.

### Top performing firms

Firms with the largest value of assets, asset growth and revenue were generally those that are highly diversified either in terms of production activities or geographical location. These firms included Allied Electronics, Bell Equipment, Invicta Holdings and Metair Investments. The firms that stood out in terms of growth by different measures were those that were involved in production but also the research and design for developing products.

**Figure 1: Mergers and acquisitions by location, 2011 – 2016 (2015 constant prices)**




*Source: Company annual reports*

*Note: The figure represents 73% of the value of M&A*

Growth also appears to be linked to companies that are diversified with significant financial resources. Allied, for instance, is involved in design and manufacturing of several products ranging from semi-conductor rectifier equipment, and battery chargers, to electronic signal equipment and transformers. It is present or operating in at least 19 countries globally. Similarly, Invicta is an investment holding and management company operating in three business segments: capital equipment, engineering consumables and building supplies across at least 10 African countries. Reunert has a number of smaller operations in Australia, Lesotho, Sweden, the USA, Zambia and Zimbabwe but manages a portfolio of businesses in the fields of electrical engineering, ICT and applied electronics.

Importantly, there are other firms involved in the design and manufacture of technology-related products and services which lead the rest of the sector in terms of profitability. Two relatively small firms, Ansys Ltd and Alaris, are worth noting. Ansys is a black-owned and controlled technology company founded in 1987 and specialising in the design and development of engineering solutions for the defence and information security, mining and industrial, rail and telecommunications industries. Alaris Holdings designs, manufactures and sells antennas and telecommunications products to the cellular, wireless data, and defence markets. The core strength of the business lies in its R&D capabilities, especially in the defence division.

Both Ansys and Alaris companies have experienced substantial Compound Annual Growth Rates of 52% and 44% in terms of assets, and 27% and 25% in terms of revenue, respectively from 2011-16. What this shows is that there is a small grouping of firms within the MME sector that stand out as growing firms that are expanding their capabilities even in the context of challenging demand and cost conditions. This points to a role for government support in terms of fostering and supporting these and similar firms. Their emphasis on R&D further increases the opportunities for new technologies and production processes to be developed.

**Operational challenges**

A challenging operating environment is contributing to loss of capabilities in some cases. Firms have also decided to withdraw from certain activities for reasons relating to changes in strategy or management for reasons which cannot always be discerned from the available data. However, high costs of production have, for instance, caused Labat Africa, with the leading commercial semiconductor manufacturing facility in South Africa, to shift operations from South Africa to China. Before Labat moved its operations to China, it was experiencing high profit margins for a period. During the company's move to China, profit margins declined but soon rose again once the move was complete. Labat's profit margin in 2016 was the highest of the firms assessed at 59%. There has thus been a loss to the economy in terms of capacity and potential for reinvestment and job creation in this case.

In 2016, Allied Electronics made a decision to dispose of Aberdare Cables, the largest cable company in South Africa, which was sold to a Chinese firm. The leadership at Allied also made the strategic decision to make all their remaining manufacturing divisions non-core, only maintaining its design and intellectual property divisions as core. The rationale for these decisions has been high operating costs and increasing competition from cheaper imports, although there may be other internal company strategy factors as well.

Alaris which, as discussed above, has grown significantly, has nonetheless experienced challenges due to high costs, a shrinking of the local supply chain and lack of skilled labour. The company chose to outsource the manufacture of some of its products to China. Due to the lack of skilled labour, the company also acquired a firm based in Finland (COJOT) in order to gain access to a wider talent pool and supply chain.

**Conclusion**

The large metals, machinery and equipment firms analysed here reveal a diverse picture under the overall poor performance of the sector. There are examples of firms which have leading capabilities. At the same time, businesses have been cutting back manufacturing activities in South Africa.

There is clearly a need for a two-pronged policy approach. On the one hand investment by large, listed firms in the MME sector needs to be supported with a set of industrial policies to tackle demand, skills and investment in technology. On the other hand, incentives are required aimed at small black-owned companies with the potential for growth.

Support in this instance is not necessarily financial, but can also take the form of initiatives to help develop domestic talent pool from which firms involved in intensive R&D and product design can source skilled human capital. Furthermore, to the extent that certain cost pressures are driven by factors such as trade policy, tariffs for inputs such as electricity, energy costs and other bureaucratic and compliance costs, there is scope to realign policy to support high growth potential enterprises.