Marubeni
Marubeni Research Institute

Sub-Saharan Report [Business Plus]

These reports are by Mr. Ryota Kikkawa, an expatriate employee working in Johannesburg with a view across the region.

Business Plus

With a growing population, abundant natural resources, and enormous infrastructure and industrial development potential, Africa, particularly sub-Saharan Africa, has been called the "Continent of Hope". In Marubeni's mid-term management plan, "Global Challenge 2018", sub-Saharan Africa has been cited as an important region to actively pursue opportunities to lay the groundwork for future business.

The Marubeni Research Institute has modified the "Sub-Saharan Report", which basically presented an overview of sub-Saharan countries, to focus on the latest business trends and prominent business models in the region, including Marubeni's own businesses. This revised version is called "Sub-Saharan Report [Business Plus]".

Angola Textile Plant Business/Growth Outlook in the African Plant Market

March 19, 2018

(In Angola, it is Marubeni)

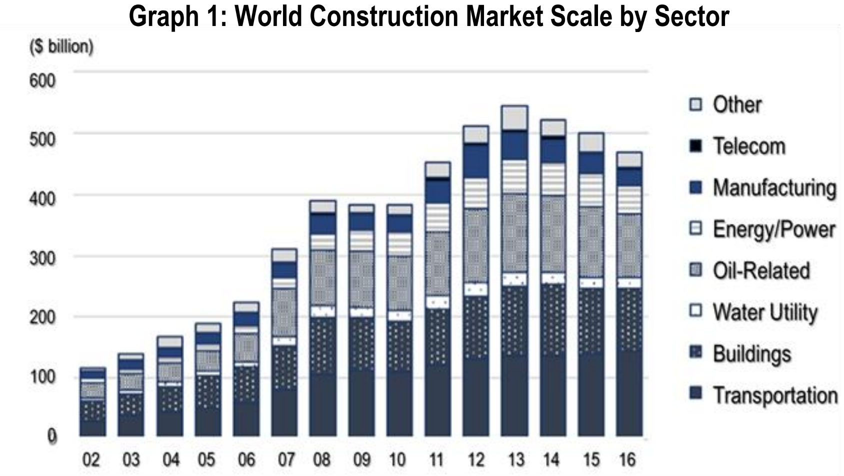
When thinking of Marubeni's activities in Africa, one of the first things that might come to mind are Marubeni's textile plants in Angola. So, this time, in terms of Marubeni's African business, in a word, I am going to cover the plant business.

World Infrastructure and Plant Construction Market

In 2016, the world's infrastructure and plant construction volume, in monetary terms, came to about $470 billion. Despite steady growth up until 2013, the market turned sluggish in 2014 on the downturn in crude oil prices and with political turmoil in a number of countries as a backdrop. Nonetheless, the market has been able to maintain a size well over $400 billion, and needless to say, it is one of the most important fields and businesses for Marubeni to be in.

Looking at the scale of the construction field by sector we see that transportation-related infrastructure, such as roads and bridges, is the largest at $144.4 billion, while oil field development, refineries and petrochemical plants was next at $104.5 billion, followed closely by the construction of commercial and office buildings at $104.1 billion. Despite a slowdown in the construction of power plants in the energy field and telecommunication facilities, the construction of manufacturing plants, including textile plants, has been expanding.

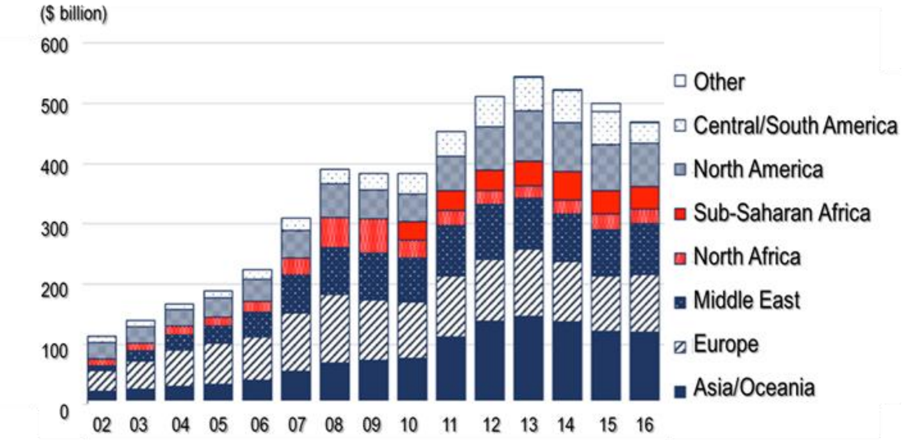
Graph 1: World Construction Market Scale by Sector



Source: ENR Note: Prior to 2011 the total was the aggregate of the world's top 225 engineering companies, from 2012 the top 250 engineering companies.

Next, regarding the scale of the construction market by region we find that Asia/Oceania is the largest market at about $120 billion, followed by Europe at $96 billion and the Middle East with a market size of $84 billion. In terms of growth in the construction market over the last 5 years, the U.S. has been booming with an annual average of 5%, with developing country and emerging market economy regions such as sub-Saharan Africa and Asia having expanded at 3% and 2% yearly clips respectively.

Graph 1: World Construction Market Scale by Region



Source: ENR Note: Prior to 2011 the total was the aggregate of the world's top 225 engineering companies, from 2012 the top 250 engineering companies.

In relation to Japanese companies' plant construction contracts, we find that the neighboring Asia-Oceania region accounts for fully 70% of their total contract amounts worldwide. Although the number of contracts has been declining in recent years, led by large-scale power plant orders, the value of the contracts was actually up in fiscal 2016 compared to the previous fiscal year. Also, in fiscal 2016, Africa was the second largest market for Japanese companies in terms of value next to Asia-Oceania. Japanese companies have begun to focus more and more on the African market with Japanese companies having signed a contract in 2017 for the construction of a large-scale LNG plant in Mozambique among others.

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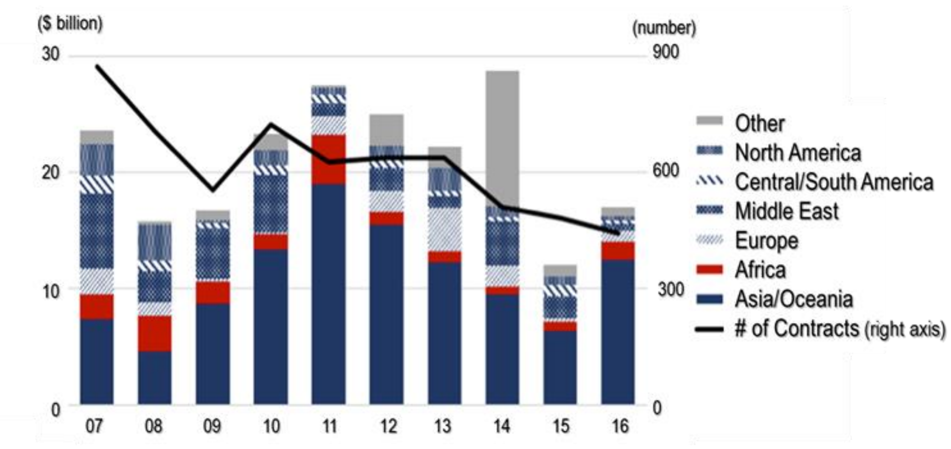
Graph 3: Number and Value of Japanese Companies Plant Construction Contracts



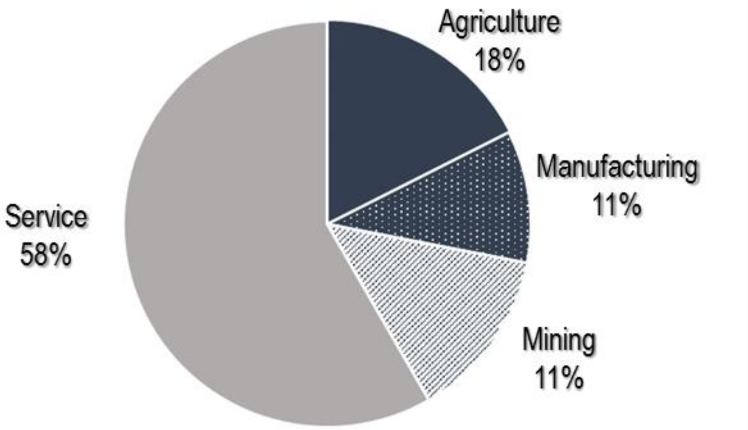
Source: Japan Machinery Center for Trade and Investment

African Plant Construction Market Expected to Grow

Although it cannot currently be said that the African plant construction market is large, it is expected to grow sharply. Potential (latent) demand, especially in such basic infrastructure as power plants (energy), transportation and water utilities, is expected to climb to around $50 billion per year in the near future, and with a growing population it will likely reach $150 billion annually sometime over the next 10 years according to African Development Bank forecasts. If it does reach $150 billion a year, Africa will become the world's largest market for construction demand.

Overall Africa's economy has been sluggish due to the decline in resource prices in recent years. African countries that achieved high growth rates on the back of economic structures highly dependent on energy and metal and mineral resources suffered from inflation caused by fiscal deterioration and higher import prices following the fall in resource prices. As a result, the living conditions of many people have worsened. Given such vulnerable economic structures it is urgent for these countries to implement industrial diversification by nurturing various domestic industries. In Africa, manufacturing's share of GDP, at 10%, is still quite small, meaning there is enormous potential to be found in this sector. In addition to the potential enormous demand for infrastructure, Africa's, especially sub-Saharan Africa's, current focus on fostering its manufacturing industry will certainly heighten competition in the plant construction business market there.

Graph 4: Sub-Saharan Africa's Share of GDP by Industry



Source: World Bankt

Angola Textile Plants

As background to Marubeni's textile plant undertaking in Angola, note that with oil making up 90% of Angola's exports even among Africa's natural resource dependent countries Angola is one of the most highly dependent on natural resources. Moreover, given that there is almost no manufacturing industry in the country it is heavily reliant on imported goods (note 1).

Angola was though, particularly former Angola, a major cotton producer up until the 1980s. However, the war for independence (1961 - 1975) and the Angola civil war (1975 - 2002) devastated much of the land, and this combined with a fall in international cotton prices led to a sharp decline in cotton production in the country. With these circumstances as a backdrop, Marubeni's plant unit took on the challenge to rehabilitate dormant state-owned textile factories as part of Angola's industry diversification plans. Marubeni received orders for the rehabilitation of 3 domestic plants located in Luanda, Benguela and Dondo. All phases of the refurbishment were completed in 2015 with the plants starting operations the same year. The raw cotton used in these 3 plants is imported from Greece and India where it is spun, sewn and dyed into fabrics for uniforms, into bed sheets, towels and blankets (also apparel) and wholesaled to domestic hotels and hospitals among others. In addition to using the latest machinery, the plants' redesign also requires the use of human hands creating hundreds of jobs in the process. Also, as part of the contract for these plants, Marubeni also provides worker training in conjunction with the Brazilian vocational school SENA. As the demand for maintenance and operation of plants is increasing in the region such high value-added activities as human resource development are now highly appreciated and valued.

The "Nova Textang II" Plant in Luanda

Pictures: Modern textile machinery neatly and cleanly arranged, a rare sight in Africa. Besides fabrication and dyeing the machines also produce prints.

Some of the products (cotton yarn) produced at the factories are not only for the domestic market but, by making use of the greater Portuguese diaspora (Angola was previously a Portuguese colony) exported to Portugal, Brazil and other Portuguese speaking countries. Mr. Luis of the Nova Textang II Plant said that they plan to increase the volume of the factory in the future and besides cotton yarn, also export finished textile products to the Portuguese speaking countries,

Issues and Challenges Facing the Plant Business in Africa

Challenges and issues facing the plant business in Africa do exist though. A main one is the capital funding gap disparity. As mentioned above, there is strong construction demand and needs centering on infrastructure in Africa. On the other hand, governments in Africa have no surplus capital at their disposal, with the problem being whether these countries can obtain the funding from foreign sources outside of Africa needed to meet this demand or not. The United Nations Economic Commission for Africa has pointed out that Africa faces an annual capital shortage of $93 billion up until 2020 alone to meet its infrastructure funding needs. Furthermore, due to a lack of transparent compliance and weak local management it is unlikely, at this point, that enough capital will flow into Africa from the developed countries. Of course, the procurement of funding is one of the foundations on which Marubeni's own plant business, and others as well, is built on, so the shortage of "money" is certainly a deterrent and a challenge in carrying out our plant business in Africa.

Also, the presence in Africa of China, a growing rival, acts as a rather large barrier to Japanese companies. The Chinese government has been injecting huge amounts of capital into Africa, and approximately half of all the construction contractors in Africa are Chinese companies. Plus, given Chinese companies' cost competitiveness competing with them in this African market poses a very tough challenge. China is also Africa's largest trading partner and has more than 2,300 private and state-owned companies operating there. As of 2016, China's cumulative FDI to Africa reached nearly $40 million (triple the amount in 2010) making China Africa's 4th largest investor (note 2). Furthermore, the value of China's announced greenfield investment in Africa in 2016 was the largest ever recorded, making up 24% of all announced greenfield investment, with China also becoming Africa's largest job creator in 2016 (note 3).

Prospects for the Plant Business (Mr. Toyoda, GM of the Luanda Representative Office)

About 10 years ago the Angolan government began to put a priority on domestic production to diversify its industries and decrease it dependence on its oil-based economy. This grew even more urgent from 2015 due to the sharp decline in crude oil prices. Industrial diversification and domestic production (manufacturing base) is an issue facing almost all countries in Africa today, but the Angolan government seems to be even more actively engaged in this regard than other countries in Africa. Despite government finances being negatively affected by the drop in oil prices, Angola still boasts sub-Saharan Africa's 3rd largest GDP, and government-related financial bodies from China, Europe and Israel, among others, as well as private European financial institutions have been providing financial support for various projects in Angola, not to mention Japan's JBIC (Japan Bank for International Cooperation) and JICA (Japan International Cooperation Agency) which have also been assertively expanding their support for projects in the country.

Due to the strong performance of our textile plants in Angola, we are looking into other potential EPC (engineering, procurement, construction) projects with the government of Angola and with the cooperation and support of both JBIC and JICA. Such projects include irrigation systems to help revitalize cotton production which could then be utilized in the country's textile plants, a cardboard (corrugated) container (box) factory as these containers are essential for the shipment and transport of industrial and agricultural products, and a sugar processing plant as 90% of Angola's sugar in now imported. (End of Mr. Toyoda's comments.)

Although the textile plant construction came first, the government's ultimate goal is to completely rebuild Angola's cotton value chain from cotton cultivation to the sale of textile products. As mentioned above, projects to restore Angola's cotton production are already being advanced, so, starting with textile plants, there is still the good possibility of expanded business opportunities in this area. Furthermore, in 2016, at TICAD VI, Marubeni signed a Memorandum of Understanding (MOU) with the Angola's Ministry of Economy and Planning and Nigeria's Investment Promotion Commission for cooperation on industrial diversification. As was the case for Japan in the past, Africa is now at the stage of development where it is necessary for the government to take the initiative in promoting the manufacturing industry. We expect that manufacturing plants or plant businesses that can respond to this industrial diversification especially by being able to accumulate foreign currency will be the ones that will be sustainable going forward.

Note 1: Due to the sharp fall in oil prices, Angola began to restrict imports, but because it is a highly import dependent country inflation rose to around the 30% level in 2016 and 2017

Note 2: China followed the U.S., UK and France. Also, China's combined cumulative ODA and FDI grew from around $1 billion in 2003 to roughly $80 billion in 2016.

Note 3: For details on FDI inflows, particularly China's, to Africa see the January 14, 2016 Sub-Saharan Africa Special Study Edition

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In order for the Marubeni Research Institute to acquire first hand information from the field and contribute to the company's strategy, young Marubeni staff well-versed in economic and industry analysis have been posted to the region.

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