

Portfolio Committee on Public Enterprises

Integrated Report and Financial Statements

4 March 2014



SOUTH AFRICAN AIRWAYS

A STAR ALLIANCE MEMBER 

2013 HIGHLIGHTS

SUPPORT FOR SOUTH AFRICA'S NATIONAL DEVELOPMENT AGENDA

- The airline contributes R8,6 billion to South Africa's GDP and is responsible for 35 000 jobs
- An additional R11 billion in catalytic demand impact on tourism and an additional 44 000 South African jobs created in tourism



2013 HIGHLIGHTS (cont)

STRATEGIC

- Compilation and submission to the Shareholder (the Department of Public Enterprises) of SAA's first-ever comprehensive and holistic Long-Term Turn-Around Strategy (LTTS) developed by Executives under the guidance and leadership of the Board
- Skills development Key Performance Indicators achieved for cadet pilots and technicians
- Three new African routes introduced: Cotonou (Benin), Abidjan (Ivory Coast) and Brazzaville (The Republic of the Congo)



2013 HIGHLIGHTS (cont)

COMMERCIAL

- Strengthened alliance and code-share relationships
- SAA achieved an overall 12% sales revenue increase
- Skytrax Award for Best Airline in Africa for the 10th consecutive year
- Four-star Skytrax rating reconfirmed



2013 HIGHLIGHTS (cont)

OPERATIONAL

- SAA achieved a 91,17% on-time performance average and won the *FlightStats* On-Time Performance Service Awards in the category “Middle East and Africa Major Airlines”



INDEPENDENT AUDITORS REPORT

The Auditors Report consisted of four main reporting areas:

- Audit opinion
- Emphasis of matter paragraphs
- Report on other legal and regulatory requirements
- Internal control



INDEPENDENT AUDITORS REPORT

Audit opinion

“In our opinion, the consolidated and separate financial statements present fairly, in all material respects, the financial position of South African Airways SOC Limited and its subsidiaries as at 31 March 2013, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Public Finance Management of South Africa and the Companies Act of South Africa”.

SAA obtained an unqualified audit opinion for financial year 2012/13 with one emphasis of matter



INDEPENDENT AUDITORS REPORT

Emphasis of matters (EoM)

The emphasis of matter was on the following item:

- *Irregular or fruitless and wasteful expenditure*

It should be noted that **EoM paragraph is not an audit finding or qualification**. The auditors were drawing attention to what is already disclosed in the financial statements and Directors' report.



INDEPENDENT AUDITORS REPORT

Irregular or fruitless and wasteful expenditure

Category of PFMA non-compliance	2011/2012	2012/2013	Movement from previous year	Causes
Irregular spend without loss	R128m	R33,8m	↓	Ground handling and office rental contracts at outstations.
Fruitless and Wasteful expenditure	R4m	R19,9m	↑	Air Chefs.
Losses due to Criminal conduct	R28k	R556k	↑	Fraud – Recoved R186k.
Recoveries	R3,7m	R187k		



INDEPENDENT AUDITORS REPORT

Remedial Actions – irregular expenditure

- The year on year improvement was due to initiatives put together during the year to ensure effective controls around identification, collating, reporting and monitoring were in place and working as intended.
- Initiatives included –
 - PFMA refresher training
 - Development of a contract management process:
 - Monthly monitoring of expired contracts through the PFMA forum
 - Implementation of SAP Contracts Lifecycle Management module
 - Vigorous training around the procurement process
 - Disciplinary action for non-compliance



INDEPENDENT AUDITORS REPORT

Remedial actions - Fruitless and wasteful expenditure

- *Fruitless and wasteful expenditure incurred for the year increase by R15million to R19.9 million largely due to inventory losses at Air Chefs. Management has instituted rigorous financial and operational controls to address the matter. These include;*
 - *Implementation of SAP Production Planning module*
 - *Redesign of Stores policies and procedures to identify efficient effective stock controls*
 - *Introducing specialised skills into the environment*
 - *Fraudulent activity being investigated and appropriate action taken*
 - *Continued emphasis on control and monitoring of stock purchases*

The actions above have resulted in a ytd reduction of 14% in Cost of Sales



INDEPENDENT AUDITORS REPORT

Losses due to criminal conduct

- *Loss due to criminal conduct amounts to R556 thousand*
 - *Cashier fraud Nairobi R98 thousand. Employee absconded, supervisor suspended and disciplinary action taken*
 - *Sourcing of magazine fraud R 385 thousand. Employee resigned to avoid disciplinary action (recovered R 180 thousand)*
 - *Theft syndicate at Air Chefs R73 thousand. Case opened with police*



INDEPENDENT AUDITORS REPORT

Report on other legal and regulatory requirements

- There were **no material findings** on the audit of predetermined objectives (KPI's)
- Achievement of planned targets – **60%** of total planned targets were achieved
 - 10 Planned targets not achieved – relates to:
 - Profitability and Financial KPI's – 6 (*currency impact on major cost elements and difficult operating environment*)
 - Funding for A320 transaction finalised 6 months ahead of delivery – *subsequent to year end funding, for first 10 aircraft finalised*
 - Cargo load factor – *internationally the airfreight market continues to suffer the effects of sluggish economy*



INDEPENDENT AUDITORS REPORT

Report on other legal and regulatory requirements (cont)

- Daily block hours per aircraft – *CPT-LHR route cancelled and aircraft redeployed on shorter sectors*
- Training spend – *KPI not achieved due to re-prioritisation of training needs*

Report Internal control

No deficiencies in internal control were identified that were considered significant



AUDIT COMMITTEE REPORT

- The Committee's assessment was that the **overall control environment has continued to improve** and was effective
- However a **concern** regarding the level of internal controls within operations where lapses in effective monitoring and enforcement by management was noted (**Air Chefs**)
- The Committee is **satisfied** with the **content and quality** of the quarterly **financial reports** issued by SAA during the year as well as the progress made in building an **effective in-house Internal Audit function**.
- The Committee acknowledges the **improvement in SAA's Risk Management function**.
- The Committee was **satisfied** that the annual financial statements were based on **appropriate accounting policies** and were supported by reasonable and prudent judgments and estimates



Financial results

Year ended 31 March 2013



SOUTH AFRICAN AIRWAYS

A STAR ALLIANCE MEMBER 

HIGHLIGHTS



Total Income up 14%



Cost savings in excess of R1bn



Operating loss before interest, tax,
depreciation and amortisation
improved by 40%



Irregular expenditure down 59%



Extended guarantee



Controllable costs up 5%



ABRIDGED INCOME STATEMENT

	2012-13	2011-12	Variance
Total Income	27,098	23,861	14%
Total Operating Costs	27,523	24,564	12%
Operating loss before interest, tax depreciation and amortisation	(425)	(703)	40%
Depreciation and amortisation	(565)	(530)	7%
Net impairment	(23)	(44)	48%
Net gain on disposal of PPE	22	25	12%
Operating loss	(991)	(1,252)	21%
Finance Costs and Investment Income	(179)	(105)	70%
Loss Before Taxation	(1,170)	(1,357)	14%
Taxation	2	514	>100%
Loss for the year (after tax)	(1,168)	(843)	39%



REVENUE

	2012-13	2011-12	Variance
Airline Revenue	25,566	22,593	13%
Other Income	1,532	1,268	21%
Total Revenue	27,098	23,861	14%

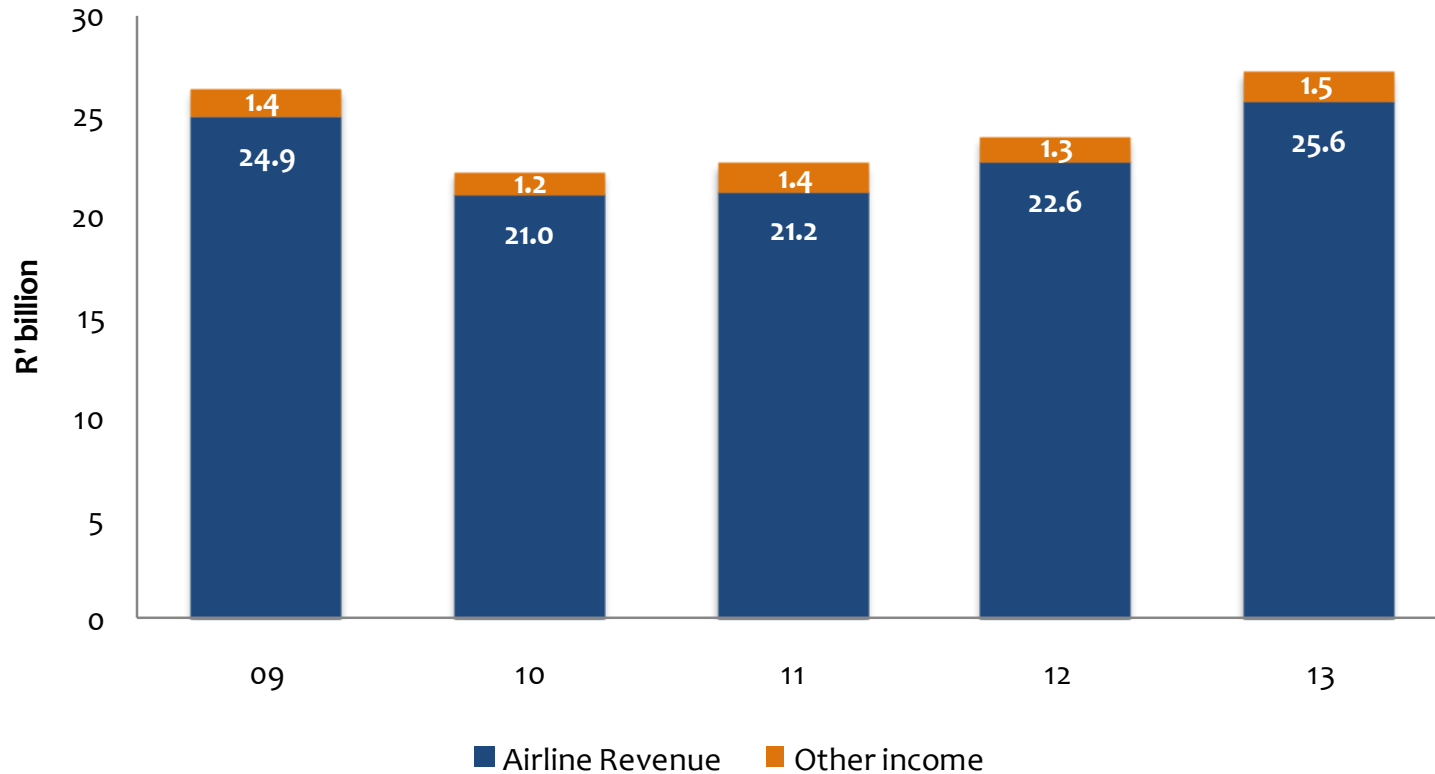
Contributing factors to increase in total revenue:

- air fares up by 7%
- 8% increase in revenue passengers
- 3% increase in load factors
- 3% increase in ASK's



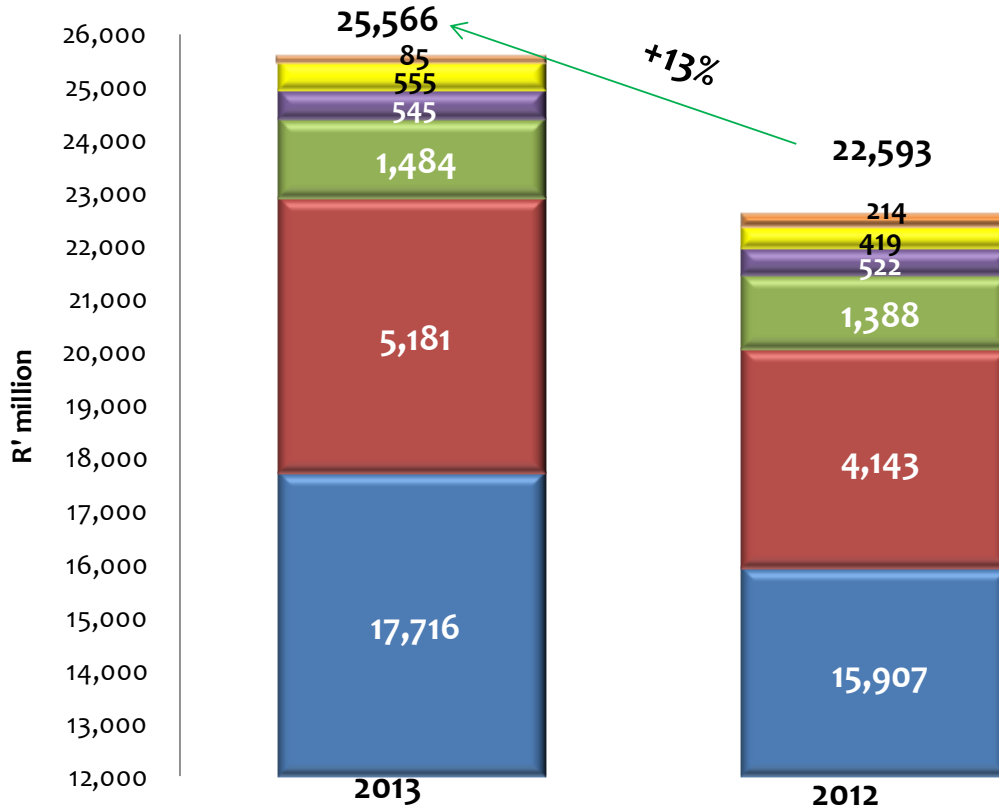
REVENUE ANALYSIS (cont)

Total Income



REVENUE ANALYSIS

Total Revenue Up by R2,973 (13%)



COMMISSION RECEIVED DOWN 60%

- Drop in commissions received largely as a result of the sale of the Galileo division.

VOYAGER INCOME UP 32%

- Higher utilisation and expiry releases.
- Increase in third party revenue

TECHNICAL SERVICES REVENUE UP 4%

- 3rd Party revenue decreased marginally but compensated by currency movement.

FREIGHT AND MAIL REVENUE UP 7%

- Cargo volume down by 2,7%.
- Yields up 9.5%.
- ATK's up 2.8%.

FUEL LEVIES AND OTHER UP 25%

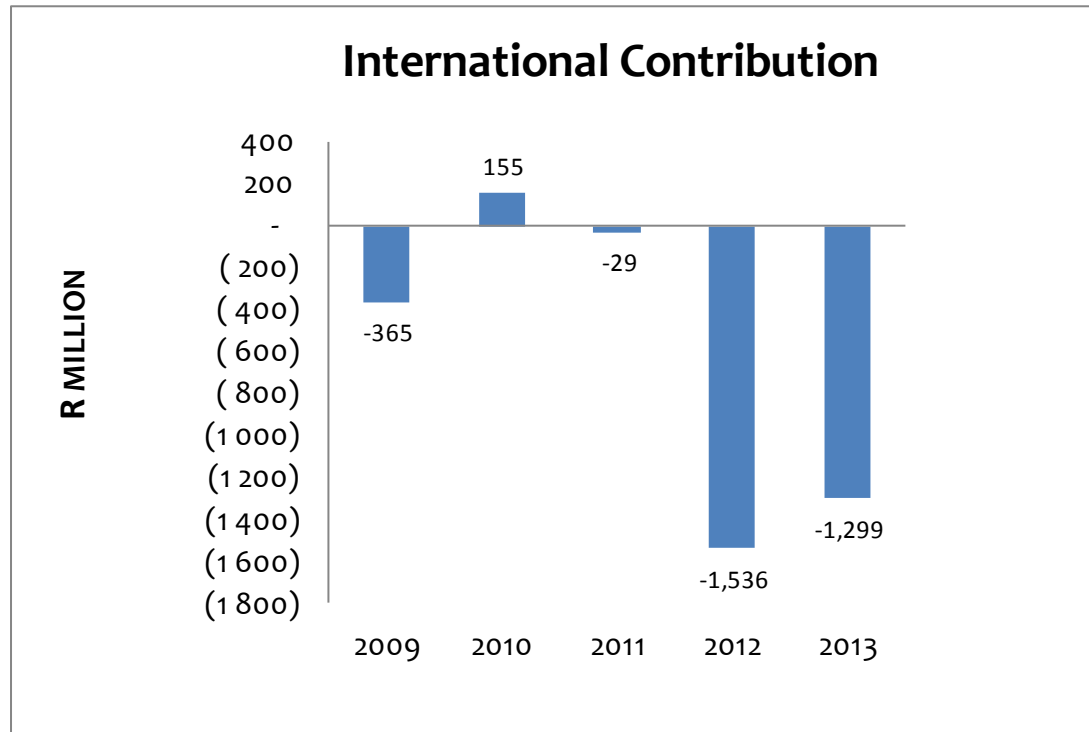
- A combination of increased YR recoveries (ZAR/USD impact) and prescribed tickets.

PASSENGER REVENUE UP 11%

- Increase in revenue passengers and RPK's.



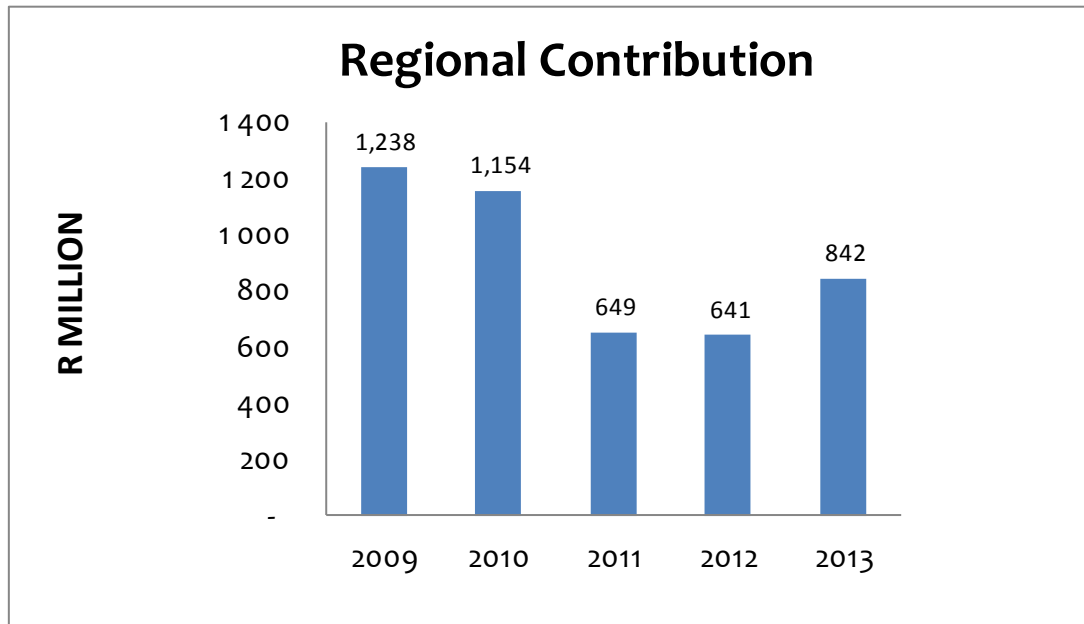
INTERNATIONAL CONTRIBUTION



- Improved 15% y-o-y
- Fuel costs had the most impact on long-haul routes
- In the years which produced losses, the average fuel price was at levels in excess of US\$ 80 and US\$ 100 (2012 and 2013).



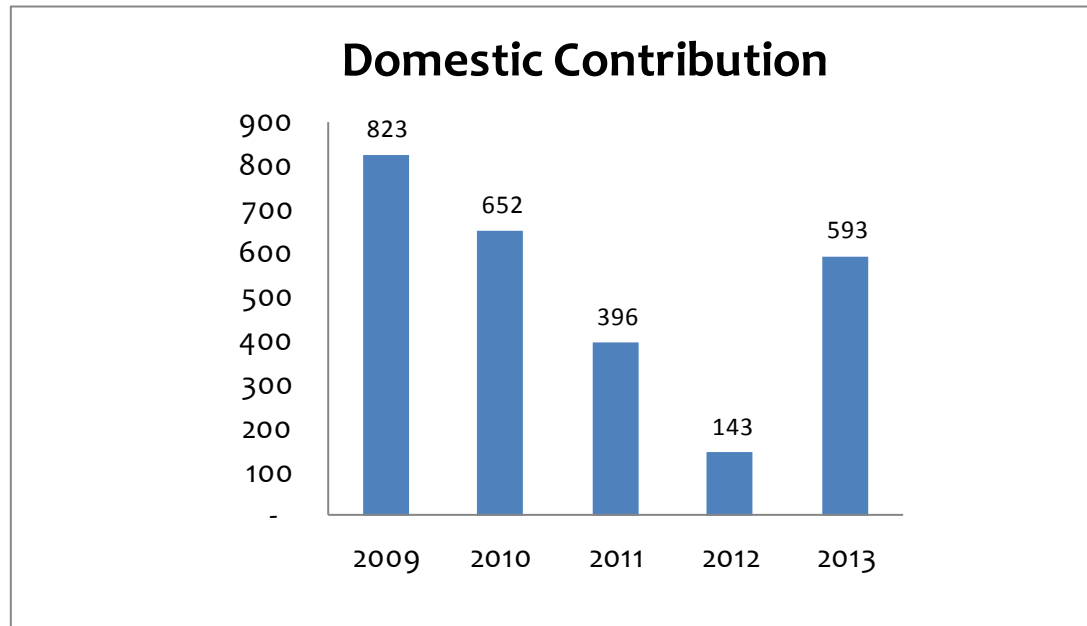
REGIONAL CONTRIBUTION



- Improved 31% y-o-y
- Competition from Middle East carriers in the region has placed pressure on average airfares
- New destinations and frequencies launched during 2011 are now maturing
- Further routes launched in 2012 are similarly starting to yield more positive returns



DOMESTIC CONTRIBUTION



- Improved 314% y-o-y
- Domestic routes have traditionally contributed positively to the airlines performance
- The 2012 financial year was particularly hard hit by the fuel price and the economic climate, restricting the Group's ability to adjust airfares
- The domestic market contracted by 15% in 2012.



OPERATING COSTS

	2012-13	2011-12	Variance
Total Operating Costs	27,523	24,564	12%

- Approximately 60% of all operating expenses are foreign currency denominated – mainly USD
- Operating costs severely impacted by weakening of the ZAR against the USD (13% y-o-y)
- Operating costs positively impacted by the results of the Cost Compression Programme – R1bn
- **In real terms, operating costs down 2% from prior year**



COST COMPRESSION PROJECT – R1bn

INDICATIVE IMPACT OF COST COMPRESSION PROJECT				
R'm		2013	2012	%
Actual Cost	Total operating cost	27,523	24,564	12%
Fx impact	Impact of exchange rate movement on non-ZAR expenditure, i.e. movement of ZAR 7.48 to ZAR 8.42 to the USD	-2,068		8%
		25,455	24,564	4%
Activity adjustment	There was a year-on-year increase in ASK as well as in Load factor. The impact of Revenue Passenger Kilometres (RPK) was calculated on the variable cost.	-847		3%
Adjustments	There was a marginal improvement in the Fuel price	146		-0.5%
Inflation adjusted	Inflation was weighted based on the currencies used for payment e.g. ZAR 5.9%, US\$ 2.9%, UK 2%, Rest 4.9 (excl Fuel)	-628		2%
	Note: Full year impact of various prior year cost increases not taken into account.			
		24,126	24,564	-2%



OPERATING COSTS ANALYSIS

Fuel cost up	15%
Employee expenses up	3%
Aircraft maintenance up	33%
Aircraft lease cost up	17%
Navigation, Landing & Parking up	18%
Other operating expenses up	6%

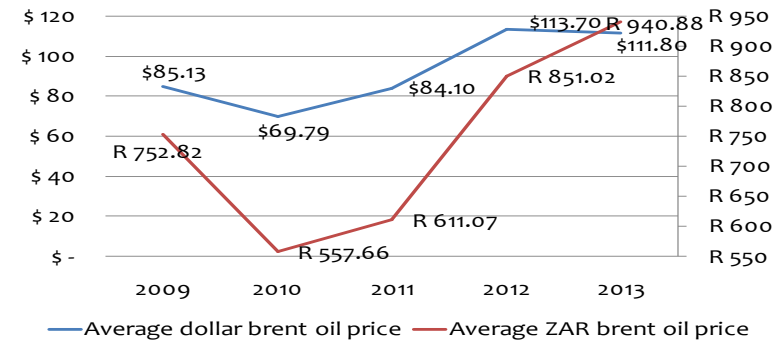
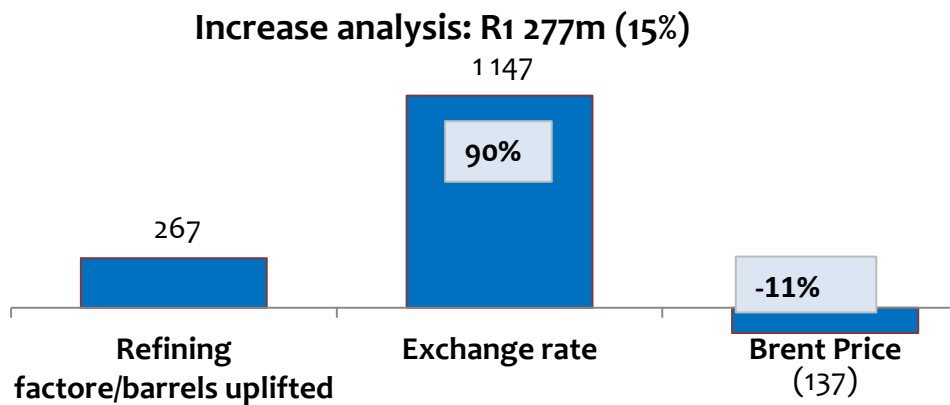


OPERATING COSTS (cont)

	2012-13	2011-12	Variance
Fuel	9,579	8,302	15%

Increase R1,277 million (+15%)

- Average Brent crude price decreased by 2% - \$113.7 to \$111.8 per barrel
- Average ZAR/USD exchange rate weakened by 13% - R7.48 to R8.42
- Fuel comprised 35% of total operating expenditure (2012: 34%)



OPERATING COSTS (cont)

	2012-13	2011-12	Variance
Employee Expenses	4,848	4,711	3%

Increase R137 million (+3%)

- Excluding the prior year pension fund adjustment, the increase is 5%
 - No increase for management
 - Pilots contractual increase of 7.2%
 - General staff increase of 6.1%

Headcount	2012-13	2011-12	Variance
Total	11,433	11,044	4%

- The headcount increased by 4%. Compulsory conversion of contract workers to permanent staff. Currently a freeze on employment and only critical positions are being filled.



OPERATING COSTS (cont)

	2012-13	2011-12	Variance
Aircraft Maintenance	2,310	1,739	33%

Increase R571 million (+33%)

- Maintenance cost contractually driven – PBTH, maintenance reserves and return conditions
- The increase in Aircraft Maintenance costs can be analysed as follows:

Increase in costs attributable to weakening of the Rand	18%	R314m
Additional provision raised due to changes in the fleet plan: <ul style="list-style-type: none"> • Early return of 6 A319-100 aircraft • Extension by one year of the A340-200 aircraft • Extension by two years of one A340-600 aircraft 	4%	R72m
Total increase in Material cost	11%	R185m
Total increase	33%	R571m



OPERATING COSTS (cont)

	2012-13	2011-12	Variance
Aircraft Lease Costs	2,097	1,797	17%

Increase R300 million (+17%)

Increase attributable to the following:

- Full year impact of new A320's and A330's entering the fleet in prior year
- The impact of the weakening ZAR

Leased fleet	2010-11	2011-12	2012-13	Change
A330	2	6	6	-
B737	25	22	21	-1
A319	11	11	11	-
A320	0	2	2	-
A340	16	11	11	-
Total	54	52	51	-1



OPERATING COSTS (cont)

	2012-13	2011-12	Variance
Navigation, Landing & Parking	1,748	1,476	18%

Increase R272 million (+18%)

- Excluding the exchange rate impact, the increase versus the prior year is R243 million (+14%)
- Landing and Parking
 - The Landing and Parking fees contributes to the bulk of the increase in this expense line
 - The ACSA increase of 28% only came into effect in December 2011, therefore the 2012-13 bears the full year effect of the increase



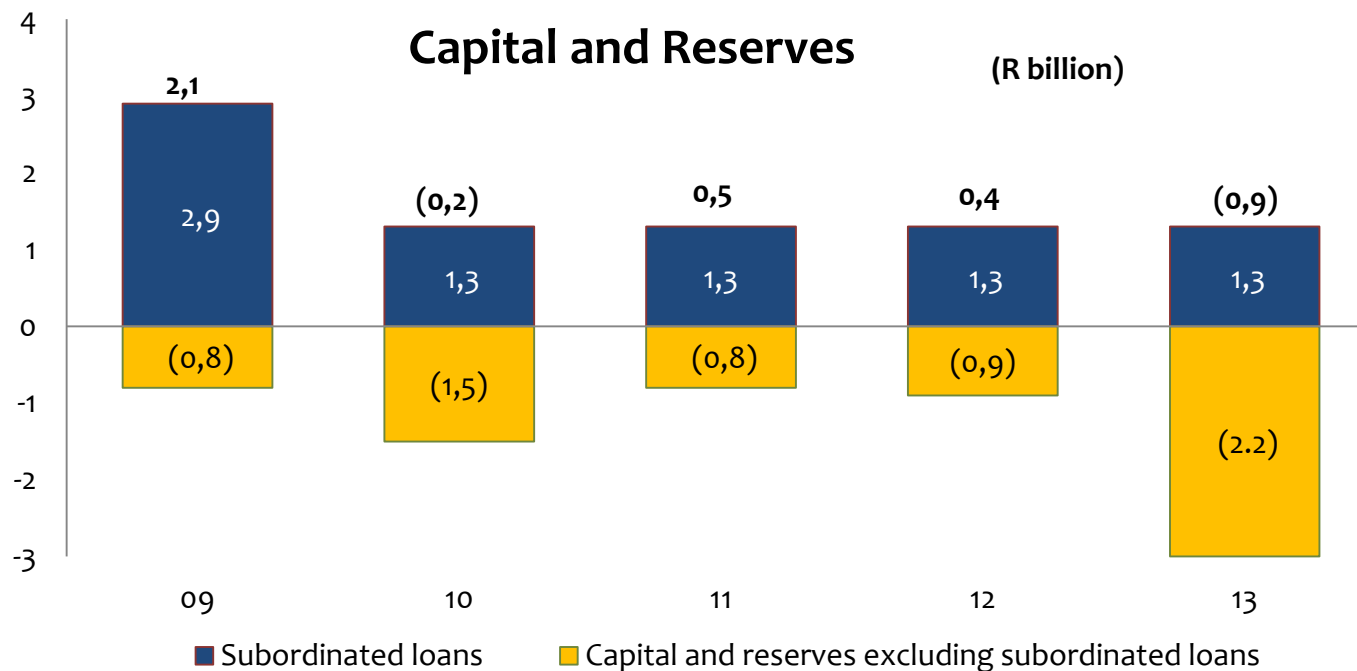
FAIR VALUE MOVEMENTS & TRANSLATION DIFFERENCES

	2012-13	2011-12	Variance
Net translation gain on foreign assets and liabilities	179	81	>100%
Net fair value loss on hedging instruments	(84)	(18)	>100%
- Realised gain on derivatives	181	211	-14%
- Fair value loss on derivative financial instruments	(265)	(229)	-16%
Total fair value movements and translation profit	95	63	51%



STATEMENT OF FINANCIAL POSITION

	2012-13	2011-12	Variance
Capital and Reserves	(2,149)	(857)	>100%
Subordinated Loan	1,300	1,300	0%
Total Capital and Reserves	(849)	443	>100%



STATEMENT OF FINANCIAL POSITION

	2012-13	2011-12	Variance
Total Non-current assets	8,145	7,833	4%
Total Current Assets	4,475	5,654	-21%
Cash and Cash Equivalents	(1,100)	(33)	>100%
Other Current Assets	5,575	5,687	-2%
Total Non-current Liabilities	3,265	4,079	-20%
Long-Term Loans	1,020	1,305	-22%
Other Non-current liabilities	2,245	2,774	-19%
Total Current Liabilities	10,204	8,965	14%
Net Assets	(849)	443	>100%



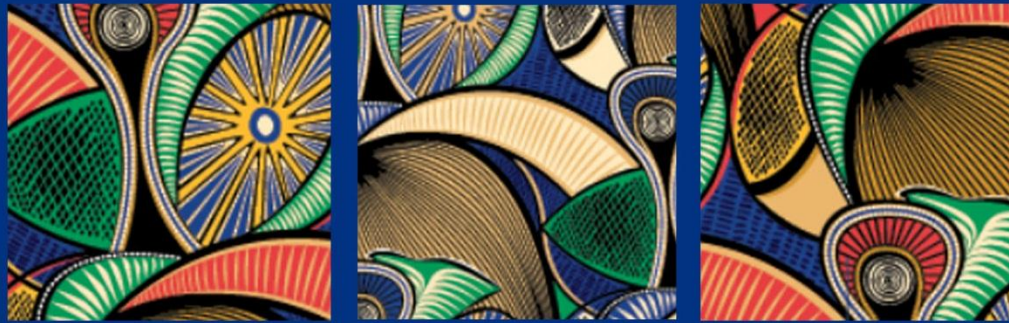
CASH FLOW

	2012-13	2011-12	Variance
Net cash and cash equivalents	(1,100)	(33)	>100%

- R5m net cash generated from operating activities (2012: -R1.1bn)
- Net Capex additions of R423m during the current financial year
- PDP payments of \$45.5m (R383m)
- Repayment of R208m on Long-term borrowings



THANK YOU



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