

National Treasury Presentation to the Standing Committee on Finance: South African Airways SOC Ltd (“SAA”)

Presenter: National Treasury | 18 November 2015



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

90 day Action Plan

- In November 2014, the Ministers of Public Enterprises and Finance required that decisive action be taken to strengthen governance, curtail losses and put the airline on a path to financial sustainability
- The aim of the 90 Day Action Plan was to fast-track implementation of stalled initiatives from the Long Term Turnaround Plan (LTTS) so as to stabilise SAA whilst recognising that it would take a longer period of time to fix the airline
- The key achievement of the 90 Day Action Plan was that decisions were taken that could enable SAA to achieve up to R1.25 billion in savings during the 2015/16 year. The savings are made up of:
 - R440 million through network changes (closure of Mumbai and Beijing routes less anticipated initial losses on Abu Dhabi route that is to be opened)
 - R290 million relating to fleet refinancing and composition changes (extension of the wide-body leases; A330 for A320 swap)
 - R100 million through recovering stalled LTTS implementation measures
 - R425 million from reviewing onerous agreements including over 150 procurement contracts.
- SAA's internal audit have confirmed that R1.1 billion of the savings can be achieved. A further review will be conducted at the end of the year to verify the full savings that were achieved.

Long Term Turnaround Strategy and Corporate Plan

- In 2013, SAA developed a Long-Term Turnaround Strategy (LTTS) which was tabled in Cabinet for noting. The LTTS outlined five strategic objectives for the airline:
 - Support South Africa’s National Development Agenda;
 - Achieve and maintain commercial sustainability;
 - Provide excellent customer service;
 - Achieve consistent, efficient and effective operations; and
 - Foster performance excellence.
- Together with government SAA reviewed and refined the LTTS.
- SAA’s Corporate Plan outlines the airline’s plan for implementing the refined version of the LTTS over the next three years.
- The Corporate Plan was tabled in Parliament on 30 June 2015.

Long Term Turnaround Strategy and Corporate Plan

- SAA's strategy focuses on revenue enhancement, cost containment and improving accountability and performance management.
- SAA's projections indicate that it will achieve a positive operating profit (EBITDA) in the 2016/17. The airline is projecting that it will become profitable after five years.
- The Aviation Expert (Deloitte) that National Treasury had appointed as advisers identified a number of potential opportunities for strengthening the Corporate Plan and accelerating the turnaround. In the 2015 Shareholder Compact, SAA was tasked with investigating these opportunities.
- The outcome of the review by the Aviation Expert has been shared with SAA through workshops with the Board, Executives and key members of the management team

Progress in implementing the LTTS

- National Treasury has been closely monitoring implementation:
 - Weekly meetings between NT and SAA to discuss progress on outstanding matters
 - Monthly and quarterly meetings to discuss progress on the implementation of Corporate Plan
 - Oversight of development of a consolidated network and fleet plan between SAA and SAX
 - Oversight of renegotiation of commercial agreements between SAA and SAX
 - Meetings between the Minister and Board to discuss key issues
- There are 51 key performance indicators (KPIs) that SAA is required to deliver on in terms of its 2015 Shareholder Compact
 - Of the 30 KPIs applicable in the first quarter, SAA has only delivered on 10, 8 are still to be determined and 12 were not met (Annexure A)
 - Of the 45 of the KPIs applicable in the second quarter, SAA has met 24, 3 were yet to be determined and 18 were not met. Annexure A)
- SAA has been required to provide explanations for any targets that were not met and to indicate mitigating actions

Year to date financial performance

Key Financial Indicators (R million)	Sep-15			Status
	September YTD Actual	September YTD Budget	Variance	
Income Statement				
Total Revenue	12868	14591	-13.39%	
Other Income	1603	1483	7.49%	
Operating Costs (including Operating Leases)	-14988	(16091)	-7.36%	
Earnings before interest, tax, depreciation and Amortisation	-517	(18)	96.52%	
Net Finance costs (Including Forex gains/losses)	305	(358)	217.38%	
Depreciation and Amortisation	-444	(278)	37.39%	
Net profit/ (loss) before tax	-656	(662)	-0.91%	
Profitability and Efficiency				
Operating expenses to Revenue %	-116.5%	-110.3%	6%	
EBITDA Margin	-4.0%	-0.1%	3157%	
Net Profit Margin	-5.1%	-4.5%	12%	
Balance Sheet and Solvency				
Total Assets	13238	20834	-36%	
Total Liabilities	22232	30869	-28%	
Total Equity	-8994	(9036)	0%	
Debt Ratio	1.68	1.48	13%	
Debt to Equity Ratio	-2.47	(3)	-28%	
Interest Coverage Ratio (times)	-2.44	(1)	202%	
Liquidity				
Current Assets	8669	16112	-46%	
Current Liabilities	14124	14380	-2%	
Current Ratio	0.61	1.12	-45%	
Cash Ratio	0.04	0.01	213%	
Quick Ratio	0.57	1.07	-47%	
Cash flow Indicators				
Net Cash Generated from Operations	-676	n/a	n/a	
Operating Cash flow to Sales Ratio	-30%	n/a	n/a	
Closing Cash Balance	326	n/a	n/a	

- Revenue for the first 6 months was 13.4% below budget due to poor performance on passenger revenues on the international and regional routes
- Operating costs were 6.9% below budget as a result of lower oil prices offset by the weaker exchange rate, lower than budgeted block hours and the labour restructuring.
- The loss of R648 million was in line with the budget of R652 million

Liquidity position

- To stabilise SAA's financial position, a R6.488 billion going concern guarantee was issued in December 2014. This enabled SAA's 2014 Annual Financial Statements to be finalised and the Annual General Meeting (AGM) to be held on 30 January 2015
- With the support of the government guarantee, SAA secured funding to meet its liquidity requirements:
 - A total of R3.5 billion was secured and/or rolled over in December 2014
 - R1.5 billion was raised in April 2015
 - R1.5 billion was raised in May 2015

The total debt raised with the support of government guarantees is R11.4 billion

- SAA has issued a Request for Proposal (RFP) with aim of raising additional longer term debt and consolidating its debt. The airline is also be seeking unsecured bridging financing to meet its liquidity requirements whilst finalising the RFP.
- National Treasury has required that SAA develop a contingency plan to ensure that it has cash resources to meet its cash requirements at all times, including where unexpected events negatively impact on the cash flow position.

Numerous significant transactions have been considered and, where appropriate, approved

Approved

- Closure of routes to Beijing and Mumbai
- Commencement of Abu Dhabi & Abuja operations
- Extension of leases on 8 wide-body aircraft and 2 freighter aircraft
- Approval for the swap of 10 A320 aircraft for 5 A330 aircraft to address onerous contractual conditions entered with Airbus in 2002

Not approved

- Opening of a route to Khartoum due to the loss making nature of the route and the fact that it did not form part of the consolidated network and fleet plan
- Corporatisation of Voyager due as SAA failed to demonstrate value through corporatisation.

Governance

- Term of the interim Board was extended until such time as a permanent Board was appointed
- 2014/15 Shareholder Compact was amended to reflect the mandate given to the interim Board to strengthen governance, curtail losses and put the airline on a path to financial sustainability
- Memorandum of Incorporation was finalised
- Materiality and Significance Framework was approved
- Investigation into former CEO was concluded and a settlement was reached with the CEO to leave SAA
- The process for the appointment of a new CEO is underway
- 2015/16 Shareholder Compact was concluded
 - NT and DPE have aligned the SAA and SAX shareholder compacts

Finalisation of the 2014/15 Annual Financial Statements

- SAA has applied for a going concern guarantee to enable the company to finalise its 2014/15 financial statements as a going concern
- The Minister required SAA to finalise certain outstanding matters before the additional guarantee request could be considered again. Concluding these matters would assist in improving the financial performance of SAA
- An initial response was received from SAA on 29 September 2015 with a more comprehensive response anticipated on 9 November 2015
- Conclusion of the outstanding matters is delaying the finalisation of the 2014/15 Annual Financial Statements, their tabling in Parliament and the holding of the AGM.
- In the meanwhile, the extension of the Air Traffic Liability guarantee of R495 million has been extended for period until 30 September 2016.

Next milestones

- Finalisation of additional going concern guarantee of approximately to sign off on SAA's 2014/15 Annual Financial Statements
- Table 2014/15 Annual Financial Statements
- Holding of the AGM
- SAA to issue and award R15 billion RFP to consolidate all existing debt and raise additional working capital