171115SCOA

PRESENTATION TO STANDING COMMITTEE ON APPROPRIATIONS: SOUTH AFRICAN AIRWAYS & SOUTH AFRICAN POST OFFICE RECAPITALISATION

Profile Analysis

Presenter: National Treasury |

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Presentation outline

1. Introduction
2. SAA Background
3. Utilisation of Section 16 of PFMA for funding SAA
4. 2017 MTBPS Recapitalisation of SAA
5. SAPO Background
6. Government guarantees to SAPO
7. SAPO's liquidity and Risk of a call on Government guarantees
8. SAA in context of spending priorities
9. Implications for fiscal framework
10. Source of funds

1. Introduction

- The former Minister of Finance, in his February 2017 Budget Speech stated that: *"…proposals for putting the capital structure of SAA and the Post Office on a sound footing will need to be agreed. I hope that this can be dealt with in the Adjustments Budget later this year."*

- The Minister of Finance, in his MTBPS Speech state that"…*At the same time, additional appropriations of R13.7 billion to recapitalise South African Airways (SAA) and the South African Post Office (SAPO)..."*

2. Background -SAA

- SAA has been relying on government guarantees to obtain loans to fund its operations. SAA's increasing reliance on debt had resulted in the airline having a significant amount of government guaranteed debt that was maturing in late 2016 and early 2017. SAA could not repay this debt due to its low cash reserves.

- SAA, together with National Treasury and the airlines lenders agreed on funding solutions which included extending repayment dates of debt and provided for additional working capital for the airline. The extension was to allow SAA to negotiate longer-term funding agreements of between two to three years.

- In the 2017 Budget Speech, the former Minister of Finance stated that *"The financial condition of state-owned companies and public entities represents another significant risk over the medium term. Several state-owned companies - Including South African Airways -require close monitoring and may require intervention to stabilise the operations"*

- In line with the commitments made in the 2017 Budget, it had been anticipated that shortfalls in the capital structure of SAA could be dealt with in the Adjustments Appropriations budget, which was introduced in October 2017.

- This approach was partly premised on the assumption that SAA's Lenders could be persuaded to extend the maturity of its debt until the time of the adjustment budget in October 2017.

3. Utilisation of Section 16 of PFMA to fund SAA

- The rapid deterioration of SAA's cash flow position necessitated more urgent intervention.
- Section 16(1) of the PFMA enables the Minister of Finance to "*authorise the use of Funds from the National revenue Fund to defray expenditure of an exceptional nature which is currently not provided for and which cannot, without serious prejudice to the public interest, be postponed to a future parliamentary appropriation of funds*"

30 June 2017

- Intervention was required in terms of section 16 of the PFMA as a result by one of SAA's Lenders, Standard Chartered Bank, that R2.2 billion in guaranteed short term facilities it had provided to SAA be settled on 30 June 2017. SAA did not have the financial resources to settle this debt and failure to do would have resulted in cross-defaults on SAA's other guaranteed debt of R13.755 billion and General Banking facilities of R830 million at the time.
- On 30 June 2017, the Minister of Finance invoked section 16 of the PFMA and authorised the payment of R2.2 billion to SAA as a direct charge against the National Revenue Fund.

29 September 2017

- Another of SAA's Lenders, Citibank, required settlement of R1.8 billion of facilities it had provided to SAA, by 29 September 2017.
- A default by SAA on the debt owed to Citibank would have triggered a call on the guarantees by SAA's remaining guaranteed debt, which was R11.994 billion at 29 September 2017 and general banking facilities of R830 million at the time.
- SAA's Domestic Lenders also had R5.0 billion maturing on 29 September 2017 and they agreed to an extension of the maturity date of their loans subject to the following:
  - ➢ Government inject R3 billion to meet the R1.8 billion due to Citibank and to provide R1.2 billion for working capital.

- On 28 September 2017, the Minister of Finance thus invoked section 16 of the PFMA and authorised payment of R3 billion as a direct charge against the National Revenue Fund

4. 2017 MTBPS Recapitalisation of SAA

- The Domestic Lenders are amenable to extending its R5.0 billion loans to 31 March 2019 as the conditions precedent such as the R10 billion equity injection announced in the October MTBPS, the appointment of a new Chairperson, permanent CEO and CRO have been effected.
- SAA's 5 year turnaround plan stipulates a recapitalisation to restructure its balance sheet and reduce the debt and interest burden on the entity.
- A recapitalisation of R10 billion is proposed for SAA for the 2017/18 financial year, which includes the R2.2 billion transferred on 30 June 2017 and the R3 billion transferred on 29 September 2017.
- The remaining R4.8 billion will be transferred to SAA as follows:

2017/18 financial year				
Month	**31 December 2017**	**31 January 2018**	**28 February 2018**	**31 March 2018**
Amount	R1 billion	R1 billion	R1 billion	R1.792 billion

4. 2017 MTBPS Recapitalisation of SAA

Conditions for Recapitalisation of South African Airways

The following conditions are attached to the recapitalisation of SAA according to the allocation letter:

- SAA providing an implementation plan for its 5 year turnaround, approved by the Board and submitted to National Treasury by 30 December 2017;
- SAA achieving at least 90 per cent of the outputs as outlined in the Board approved implementation plan by 31 March 2020;
- The Board of SAA providing an action plan to address the findings from all independent forensic investigations by 30 December 2017;
- The Board of SAA implementing the action plan to address findings from all independent forensic investigations by 31 March 2018;
- SAA identifying non-core assets for potential disposal and the submission of recommendations thereof to the Minister of Finance for consideration by 30 December 2017;
- SAA appointing a Chief Commercial Officer and Chief Strategy Officer by 31 January 2018;
- SAA providing a comprehensive decision making framework for the commencement and cessation of routes by 31 January 2018; and
- SAA developing an integrated network and fleet plan, which complements its 5 year turnaround plan by 31 March 2018.

5. Background -SAPO

- During the period from September 2014 SAPO was experiencing labour strikes which caused severe service disruptions to SAPO's operations. As result of the strike, SAPO customers had found alternative means to SAPO's services. This negatively affected SAPO's ability to sustain its revenues.

- In December 2014, the Minister of Telecommunications and Postal Services appointed an Administrator developed a strategic turnaround plan (STP) to restore SAPO's stability, the STP was developed however, SAPO was not successful in implementing the STP because the STP did not seek to address the alignment of the group to the changing postal sector.

- In January 2016 a permanent Board and a Group Chief Executive Officer (GCEO) were appointed. Subsequently, a revised strategy that sought to address the weaknesses in the STP was developed under the leadership of the GCEO. The revised strategy seeks to diversify SAPO's revenues, by growing revenue lines for parcel mail, logistics, retail services and financial services. The focus on revenue diversification is also aimed at reducing SAPO's reliance on traditional letter mail. Moreover, SAPO indicated that it would seek to address its cost structure through a reduction in staff costs (which forms the largest cost component) along with automation and efficiencies within its operations.

- Despite SAPO's plans to diversify revenue, the mail business is still SAPO's largest revenue component to date, thus deterioration in the performance mail business has a significant impact on the overall revenue performance. SAPO's logistics business continues to struggle to show positive results. SAPO's mail volumes continue to decline amongst its' largest corporate clients as a result of mainly operational inefficiencies.

6. Government Guarantees to SAPO

- SAPO has R4.17 billion in government guarantees, which has been used to raise R3.7 billion in debt.

- The guaranteed debt was used to mostly settle overdue creditors to restore services, pay salary shortfalls and repaying overdraft facilities. The remainder of the funds were used to cover monthly operational, as SAPO could not effectively grow revenues. SAPO had anticipated that the repayment of outstanding creditors would result in the automatic return of business from clients. However, this did not materialise as clients found alternative solutions, effectively reducing mail volumes processed by SAPO. Additionally, operational inefficiencies on SAPO's part and a general decline in mail volumes accelerated SAPO's financial deterioration.

SAPO BORROWING LIMIT AND GUARANTEES				
SAPO Borrowing Limit	**Date**	**(R'million)**		
Overdraft Facility	September 2014	320		
Short term finance	April 2015	150		
Increase to raise R1 billion	June 2015	1 250		
New Borrowing Limit	May 2016	2 700		**(R'million)**
TOTAL BORROWING LIMIT		**4 420**	**TOTAL GUARANTEES**	**4 170**
TOTAL LOANS CURRENTLY		**3 700**	**TOTAL GUARANTEED EXPOSURE**	**3 700**
BORROWING LIMIT REMAINING		**720**	**GUARANTEE REMAINING**	**470**

8. SAA in context of spending priorities

Several state-owned companies – including South African Airways – require close monitoring and may require intervention to stabilise their operations. Any request for funding allocations will be considered in light of principles set out in the 2014 MTBPS – namely that approved funding cannot have an impact on the budget balance. Moreover, state-owned companies facing financial difficulty must demonstrate tangible progress in returning to profitability. Government will also explore opportunities to expand private participation.

2017 Budget Review

9. Implications for fiscal framework

Table 3.4 Revisions to the 2017/18 expenditure ceiling

	R million
Expenditure ceiling: 2017 Budget Review	**1 229 823**
Upward expenditure adjustments	**16 167**
Roll-over of funds from 2016/17	217
Unforeseeable and unavoidable expenditure	586
Section 16 of the PFMA (SAA recapitalisation)	5 208
Announced in the 2017 Budget[1]	8 609
Self-financing[2]	1 547
Downward expenditure adjustments	**(12 268)**
Declared unspent funds	(1 668)
Direct charges against the National Revenue Fund: Magistrates' salaries	(100)
Contingency reserve	(6 000)
National government projected underspending	(3 000)
Local government repayment to the National Revenue Fund	(1 500)
Revised expenditure ceiling	**1 233 722**

1. Includes the recapitalisation of the SAPO (R3.7 billion) and SAA (R4.8 billion) and the finalisation of the establishment of the Tirisano Construction Fund Trust (R117 million)
2. Spending financed from revenue derived from a vote's specific activities
Source: National Treasury

- Currently, the funding of SAA has not being undertaken in a deficit-neutral manner, resulting in a projected R3.9 billion breach of the expenditure ceiling
- However, MTBPS speech announced the sale of Telkom shares to offset this breach

9. Source of funds

- The Minister of Finance, in his MTBPS Speech stated that, "*The expenditure ceiling is threatened in the current year, as a result of government's recapitalization of South African Airways and the South African Post Office. Government is disposing of a portion of its Telkom shares to avoid a breach, with an option to buy them back at a later stage*"

- Government has already held discussions with a potential buyer/buyers, and once all the discussions and negotiations are complete, the necessary announcements will be made

- The decision was not taken lightly, but has to be considered in order to maintain the credibility of the expenditure ceiling.