Flying out of the Thunderstorm

SAA Presentation
Portfolio Committee on Public Enterprises

27 November 2018

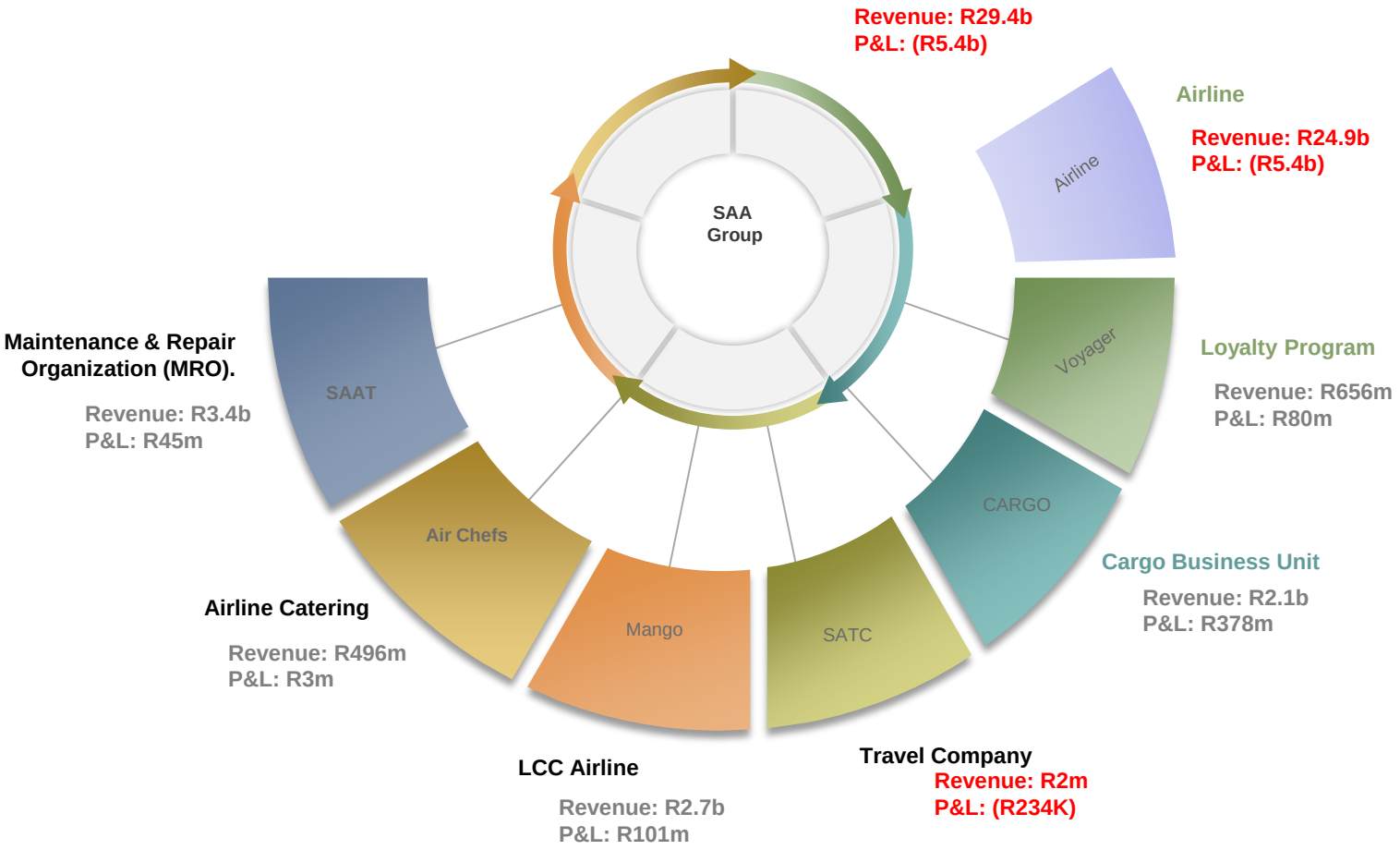
SOUTH AFRICAN AIRWAYS
A STAR ALLIANCE MEMBER

Agenda

1. SAA Introduction and Context
2. Approved Corporate Plan FY 2019-23
3. Strategy Execution
4. Solvency Liquidity & Going Concern
5. Update Corporate Plan FY2020-2023
6. Audit Findings
7. Forensic Investigations

SAA Introduction and Context

SAA Group at a glance: FY2017/2018



SAA Governing Structures

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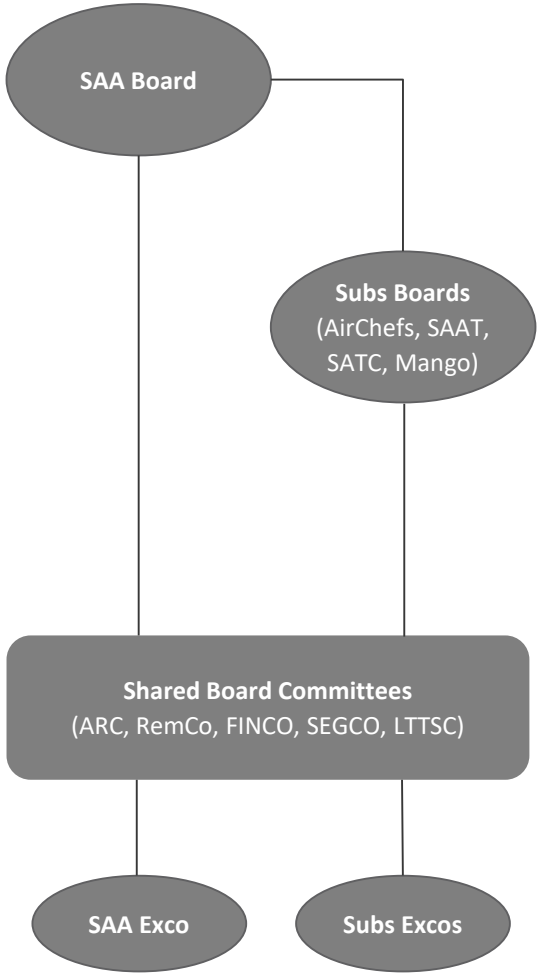


1. **Memorandum of Incorporation**
   - The SAA MoI sets out the rights, duties and responsibilities of the shareholder, directors and others within the company
   - Duties and responsibilities of directors are cascaded down to Board and Committee Charters

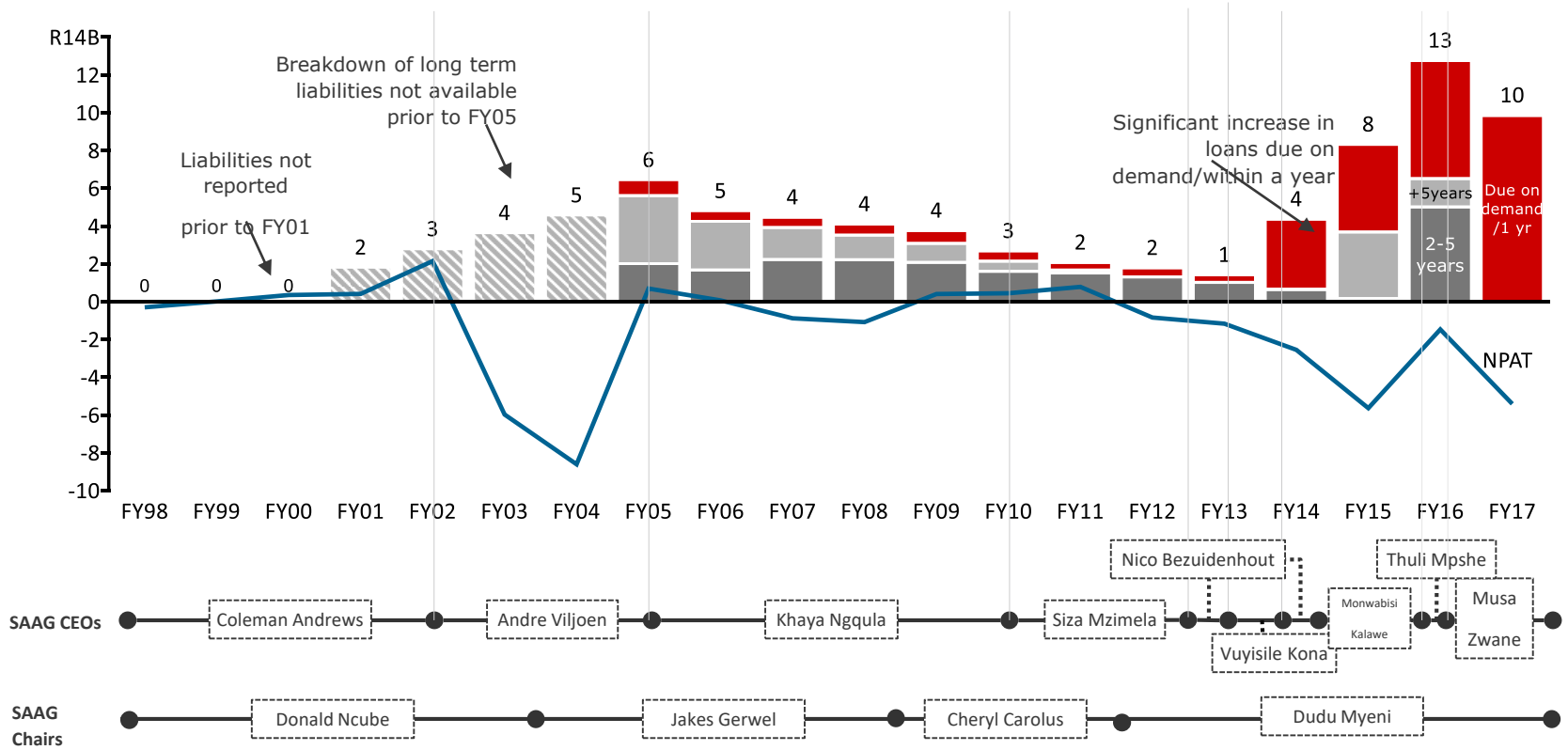
2. **Shareholder Compact**
   - The Board must conclude the Shareholder Compact with its Executive Authority annually.
   - The SC must document mandated key performance areas and indicators to be attained by the company between the Board and the Executive Authority (Treasury Regulation 29.2 of the PFMA)
   - The Shareholder Compact is the performance agreement between SAA and the Shareholder

3. **Significance & Materiality Framework**
   - "Significant" and "material" are not defined in the PFMA. TR 28.3.1 requires the Board to develop and agree on a Framework of acceptable level of "Significance" and "materiality" with the Minister
   - The SMF must be reviewed annually and should be included in the Corporate Plan. The SMF includes acquisition and disposal of significant assets

4. **DoA Framework**
   - The Board may delegate any of the powers or functions to any Board Committee or to the CEO
   - The Finance Committee is delegated to review and recommend to the SAA board any approvals above R100 million.

In recent years SAAG has experienced administrative and management turbulence, deteriorating results and increasing debt levels

SAA Group accumulated debt (R, B) split by due date



Cash outflow due to capital expenditure*	-R0.3B	-R0.4B	-R0.2B	-R0.4B	-R0.5B	-R0.6B	-R0.8B	-R1.1B	-R3.2B	-R4.4B	-R0.7B	-R0.4B
Cumulative gov. guarantee		R1.3B	R4.5B	R4.5B	R1.4B	R1.9B	R1.3B	R2.2B	R5.0B	R8.4B	R14.4B	R19.1B

Maturity

= less than 1yr = between 1-5 yrs = more than 5yrs

...And recently

2017

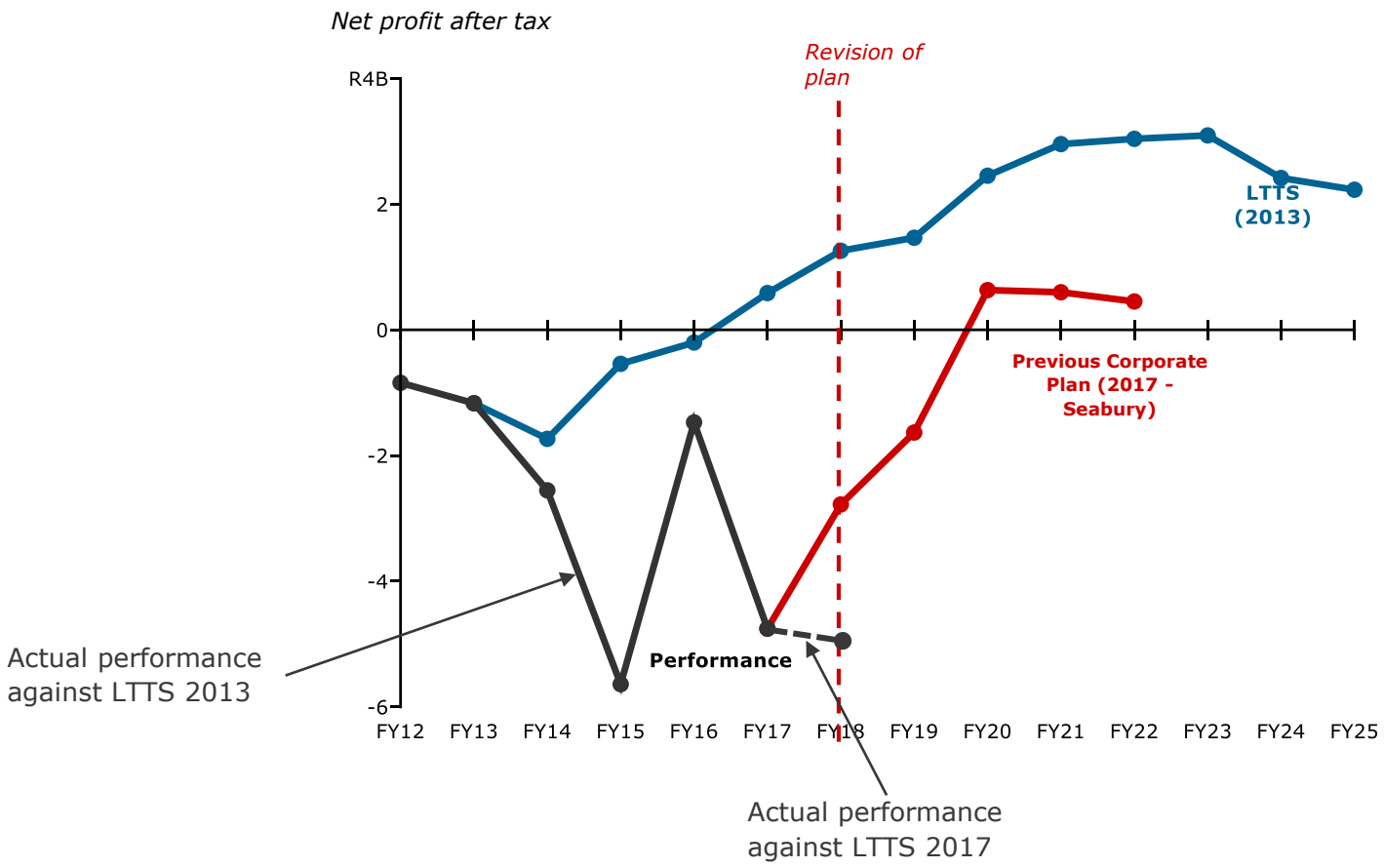
- 3 Ministers of Finance
- New Board of Directors appointed
- New CEO appointed

2018

- Transfer to DPE

Note: Guarantees accessed via Transnet prior to stand alone SOE status;
*capital expenditure is investment in aircraft, property, equipment & intangible assets
Source: Company financial statements, SA Treasury budget review

SAA is not short of strategies… What has been lacking is the relentless focus on execution of strategy



Reasons for Underperformance

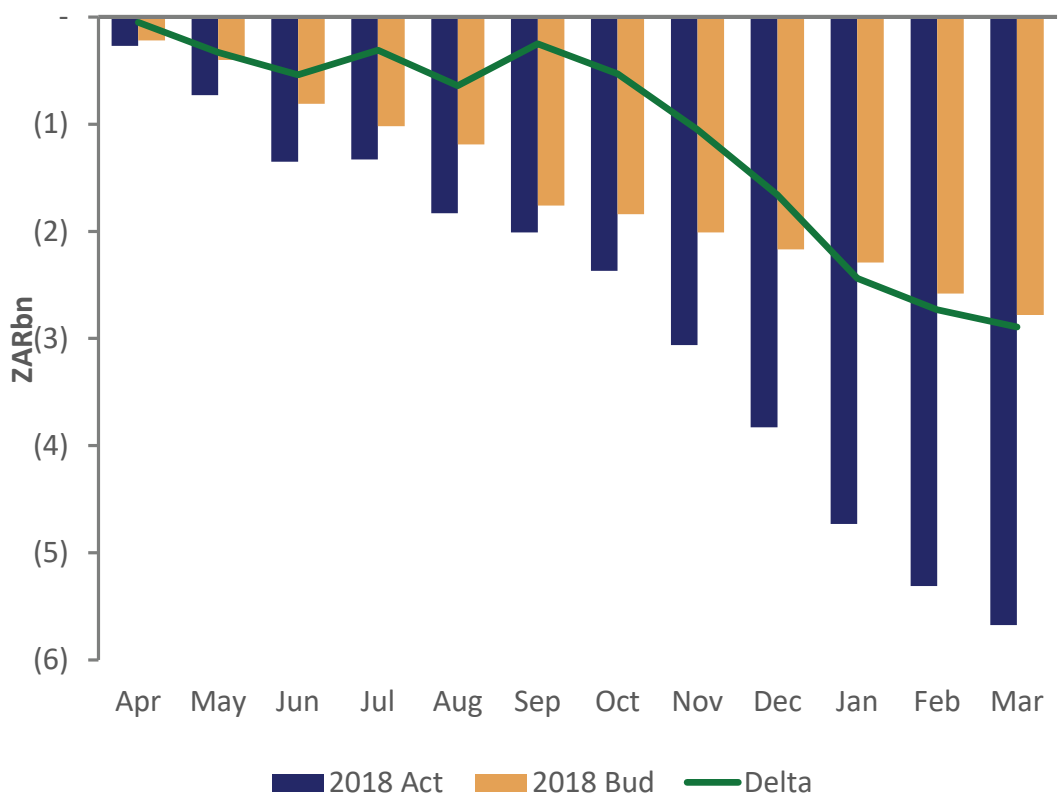
- Lack of **coherent, integrated strategy**
- Overt focus on **cost reduction** without adequately addressing **operating model constraints**
- **Limited commercial and business skills** to drive revenue growth
- **Reduced customer focus**
- Inability to **attract and retain best talent** in the market
- **Poor implementation** driven by a lack of communication
- **Instability of management** and breakdown of culture
- **Slow decision-making** often due to increased management restrictions

Note: Financial Year ends 31 March; FY17 NPAT is for YTD; LTTS = Long Term Turnaround Strategy
Source: Corporate Plan, April 2017 – March 2023

As a result, in 2017/2018 financial year SAA incurred more losses than budgeted due to inability to execute strategy

FY18 YTD EBIT

SAA Group Net Profit
(YTD FY18 performance relative to budget)



Key Issues facing SAA

1. Weak balance sheet and negative equity
2. Liquidity challenges
3. Negative publicity on SAA
4. Previous Board dynamics not helpful
5. Suppliers lost confidence in SAA
6. Banks closed all credit lines to SAA
7. Six months procurement moratorium cost the airline about R1.6 bn
8. Lack of skills
9. Instability at Exco level
10. Forensic reports pointing to rampant corruption
11. Fragmented IT systems
12. Revenue lower than direct expenditure
13. Excess flight deck and cabin crew
14. Low pilot productivity

Source: Management reports
Source: Management Reports

Approved Corporate Plan
FY19-23

Summary – FY2019/23 Corporate Plan (Approved Corporate Plan)

SAA developed its Long Term Turnaround Strategy (LTTS) in 2013, which has been met with limited success due to a failure to implement

- SAA validated the LTTS Plan in 2017 and highlighted significant gaps, such as oil price projected not higher than $45 a barrel till 2022

SAA has since revised its strategy and turnaround plan to build a commercially focused airline with customer experience as its cornerstone

Approved FY2019/23 Corporate Plan forecasts breakeven by FY2021 based on key assumptions holding true

- The group will incur financial losses of R5.2 billion and R1.9 billion for the financial years 2018/19 and 2019/20, respectively.
- Thereafter the group expects to be profitable for the remainder of the five-year period

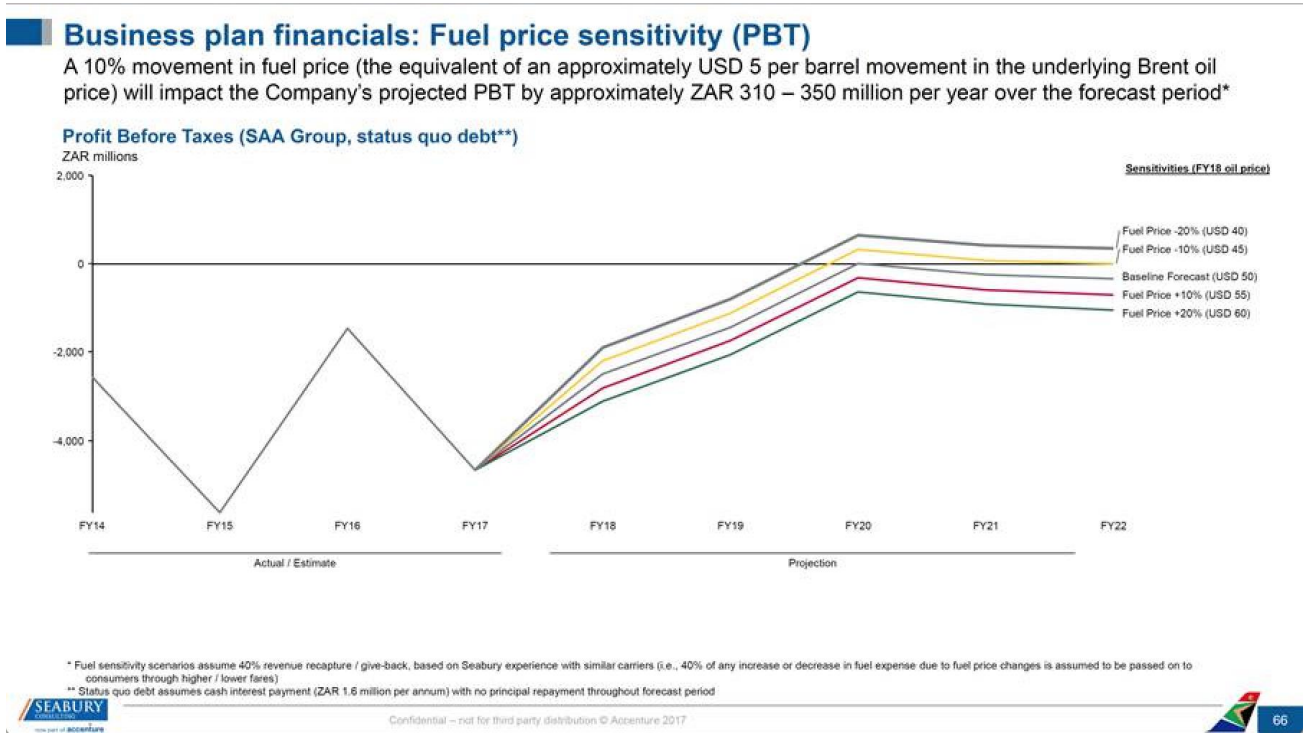
The SAA Corporate Plan is exposed to significant environmental and execution risk, driven by lack of critical skills, weak balance sheet, liquidity challenges and escalating oil prices among others

- As a result SAA reported a net loss of R5.7 billion for 2017/18
- However, YTD performance has been strong, as reflected in the financial results which have been above budget both for revenue and net loss

The 2017 LTTS developed with the support of Seabury, projected that SAA would break even in 2020…

…However, the oil price forecast at $45 a barrel was overly optimistic and the LTTS was updated

1. Upon analysis of the LTTS 2017 (Seabury) it became apparent that the break even point in 2020 was not possible due to negative movement in oil price against the projection of $45 a barrel.
2. The adjacent graph depicts oil price scenarios and their impact on the project 2017 LTTS corporate plan.
3. In this analysis the only scenario in which the corporate plan breaks even is when the oil price is at $45 dollar a barren and below.
4. By November 2017 the oil price had already reached $60 a barrel thus making the 2017/2022 corporate plan not feasible.



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SAA has since revised its strategy and turnaround plan to build a commercially focused airline with customer experience as its cornerstone

Customer Experience Leadership

Win the battle for domestic market

Focused Player in International Market

Player of substance in Regional Market

Commercially Focused Organisation

Enabled by

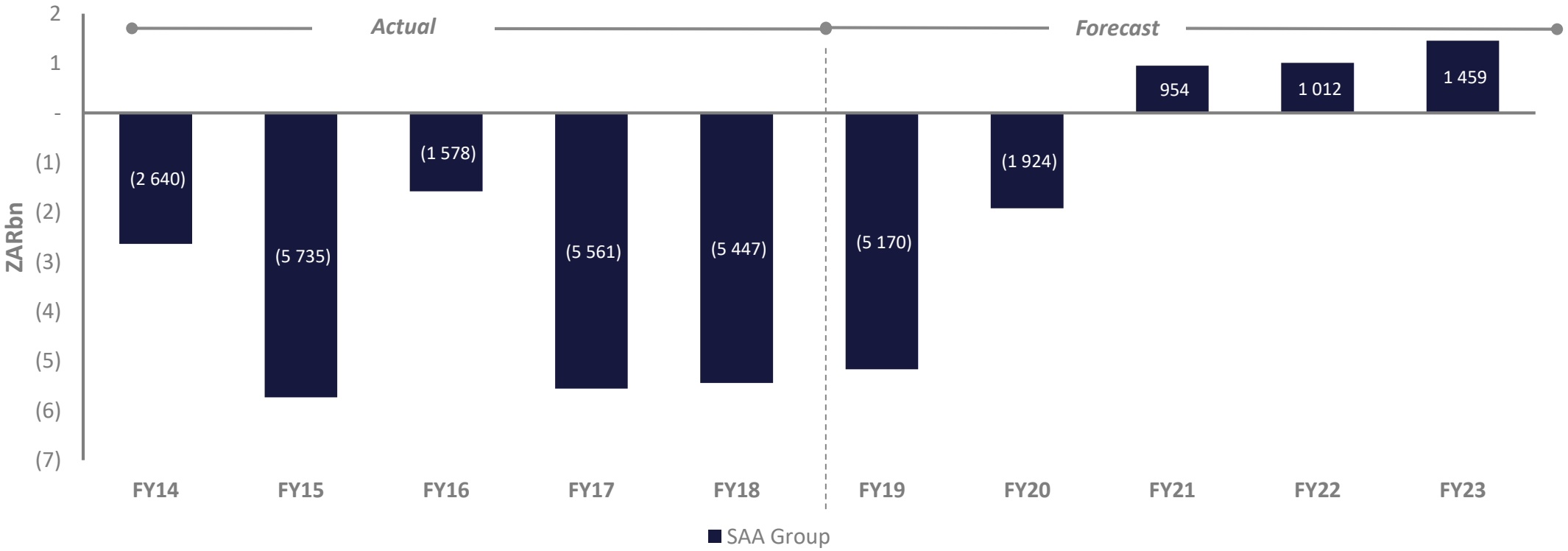
Efficient Operating Platform	Deep Aviation Skills Base	Fit For the Future Operating Model	Enabling Policy Environment	Appropriate Balance Sheet

Approved Corporate Plan forecasts break-even by FY2021 based on key assumptions holding true

Key assumption underpinning the strategy

1. Exogenous factors such as oil price and exchange rate
2. Competitive environment remains stable
3. Access to the requisite funding and appropriate capital structure
4. Securing relevant resources to implement the strategy

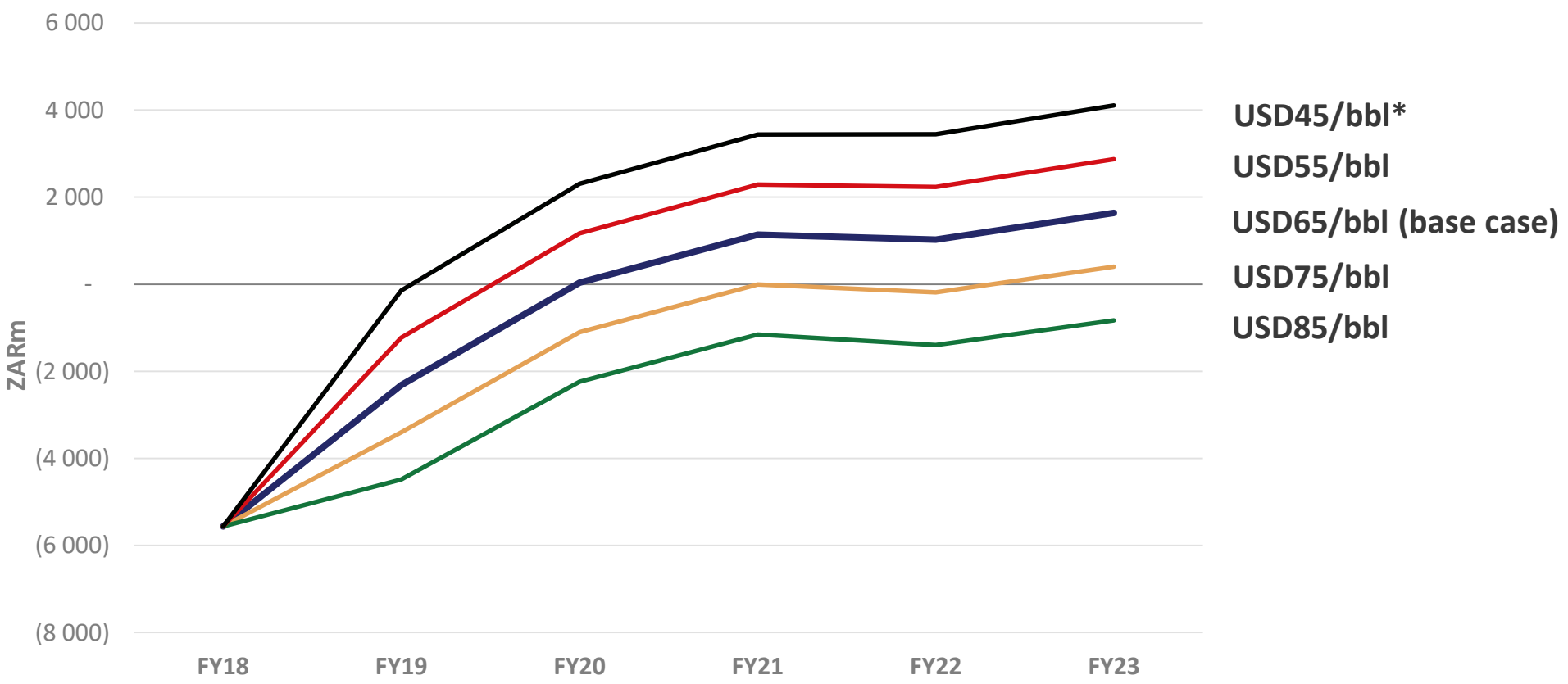
SAA Group Net Profit/Loss



Source: Management reports

Approved Corporate Plan indicates that break-even is achievable in 2021 with a Brent price of $75/bbl

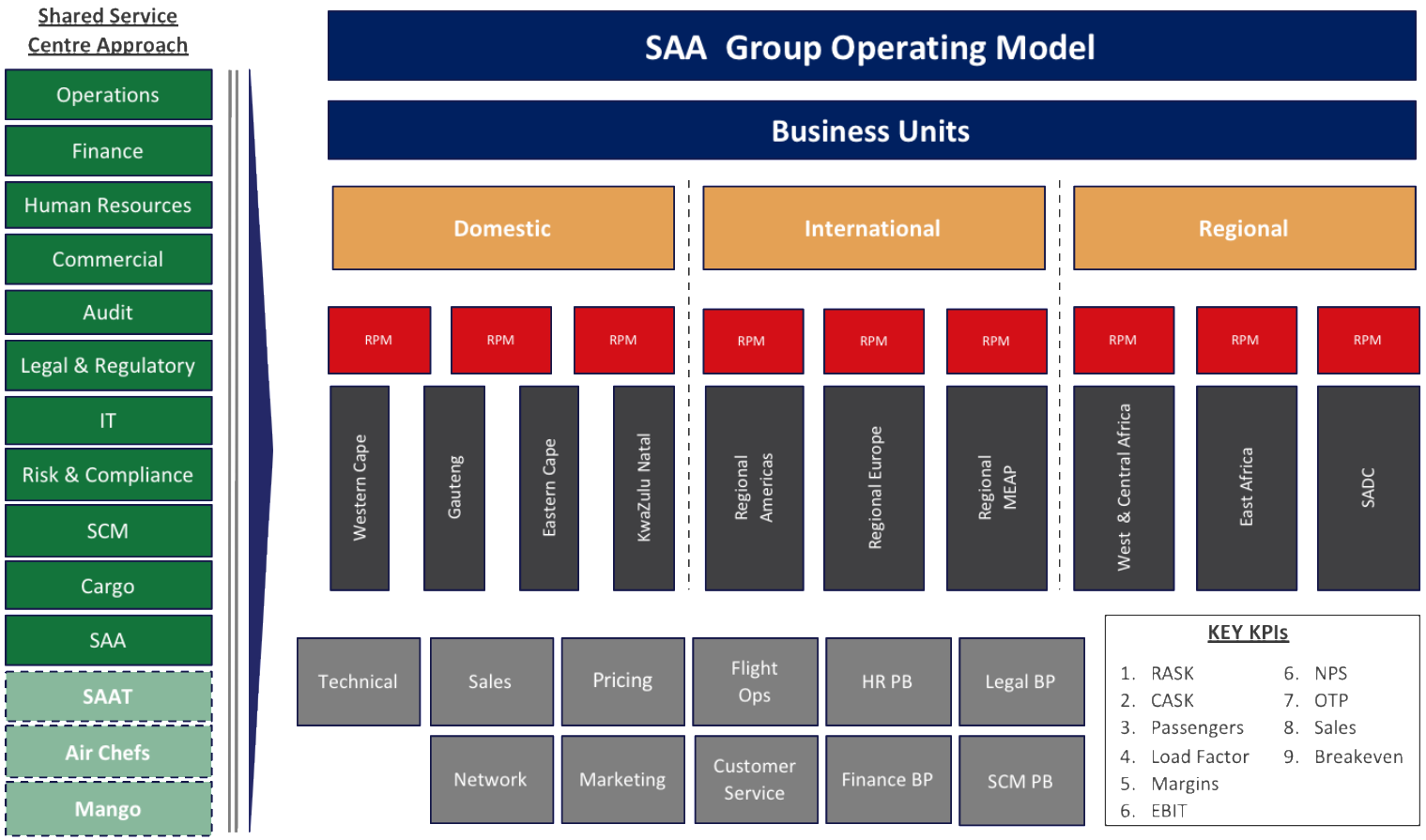
SAA Group Net Profit Sensitivity for Fuel



$1/bbl Brent change translates into c.R110m in fuel cost to the Group

* Gradual increase of $4 over the period taken into consideration across all scenarios

A new commercially focused operating model design underpins the transformation programme



The Company went out on an RFQ for a service Provider to assist with the Organisation Design programme

Potential risks to strategy implementation (1/2)

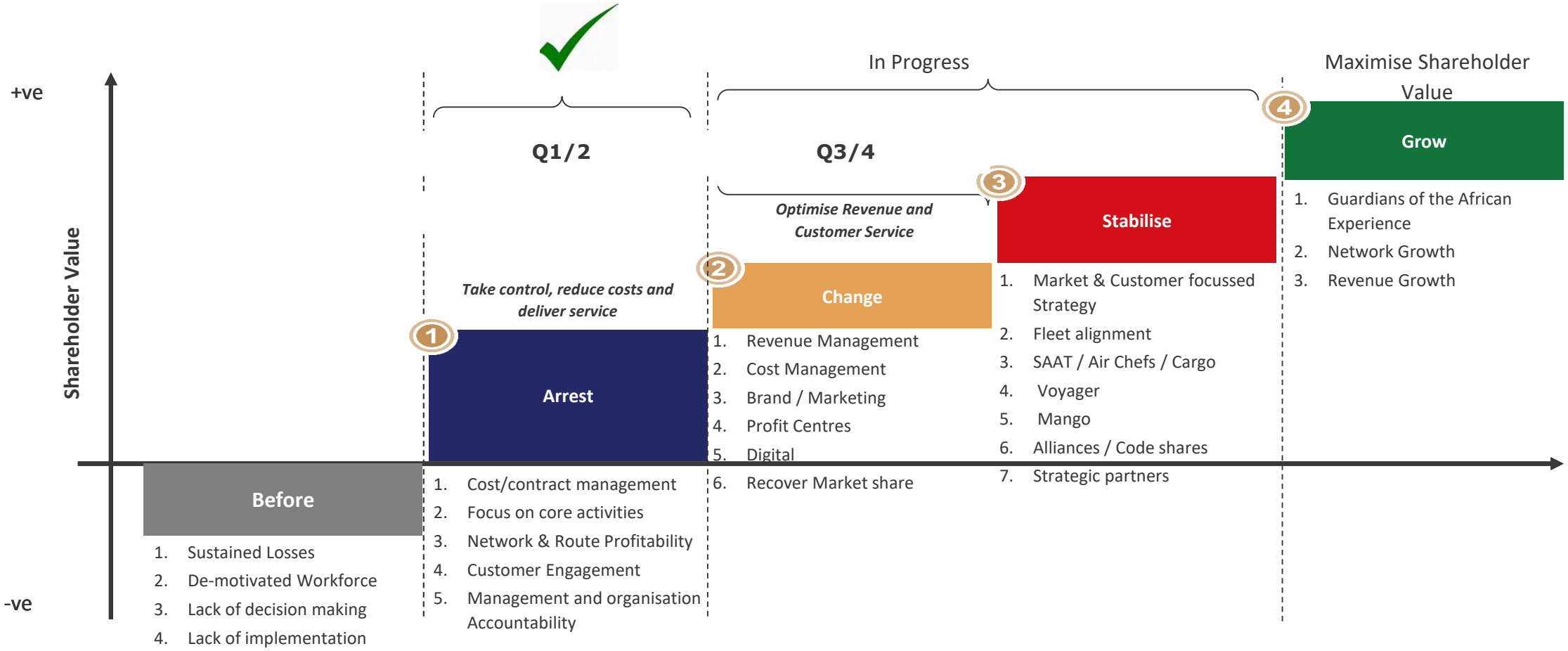
Potential risk (identified as potential events or actions that might increase risk if they were to occur)	Potential impact	Mitigation
SAA not able to get credit line for working capital funding	SAA won't be able to pay suppliers, creditors and employees	Loan Refinance Repatriate Angola & Zimbabwe funds Engage the banks on new strategy Engage National Treasury for capitalisation
Significant increase in oil price	SAA cost to operate will increase significantly and performance covenants could be missed triggering default conditions leading to banks calling their loans	Ideally hedge some of the negative position on Fuel Pass through the fuel price increase to the customers
The shareholder shifting focus from building a financially sustainable airline to developmental airline without requisite funding	SAA would remain unprofitable and ultimately closes unless such mandates are backed by financial injection	Agree on funding of the developmental mandate
Lack of agreement on the change programme leading to labour unrest	Strike action would disrupt business performance leading to penalties and missed revenue with debilitating effect on SAA	Management – union bilateral sessions Labour Forum to be part of change programme Management – union bilateral sessions Labour Forum to be part of change programme
Lack of management capacity to execute on the strategy	Management lacking capacity and capability to execute on the strategy.	Recruiting top skills to support change agenda
International flights bypass JNB Hub	JNB hub strategy would be severely undermined and compromised with the effect of SAA's domestic and international market share would shrink.	Strengthen government relations team, strengthen aviation policy teams

Potential risks to strategy implementation(2/2)

Potential risk (identified as potential events or actions that might increase risk if they were to occur)	Potential impact	Mitigation
Failure to refinance SAA's long-term loans	SAA loans would fall due and payable	Secure loan extension on the back of strategy Shareholder to recapitalise SAA
Increased market competition on regional and international markets	Reduce SAA market share to a point in which SAA loses market relevance	Tighten cost to operate to create headroom to compete Enter into value creating partnerships
Financial uncertainty making it impossible for SAA to execute its fleet strategy	SAA would resort to leasing aircraft from lessors at significant rates compared to buying own aircraft. SAA would carry higher cost to operate than its peers thus leaving very little room to compete and win.	Secure loan extension on the back of strategy Shareholder to recapitalise SAA
Bureaucratic Supply Chain management policy	Sourcing of key capabilities takes longer thus undermining the delivery timelines of the strategy	Review SCM policy Revamp practices and bring innovation Simplify the key processes
Slow decision making at Board and Shareholder level	Board and Shareholder withholding key decisions resulting in missed revenue and cost savings benefit realisation.	Simplify processes Build trust through competence and character Negotiate a pro-turnaround DOA and SMF

Strategy Implementation Monitoring

The Long Term Turnaround Strategy leverages a structured approach consisting of 4 phases; initial phase focuses on addressing immediate remedial actions, ultimately followed by growth



Source: SAA Board Strategy pack 20180117v15

The initial phase is focused on four major areas of intervention

Revenue Stimulation Network Optimisation

1. Route Optimisation
2. Network Development
3. Aircraft Utilisation

Organisational Design

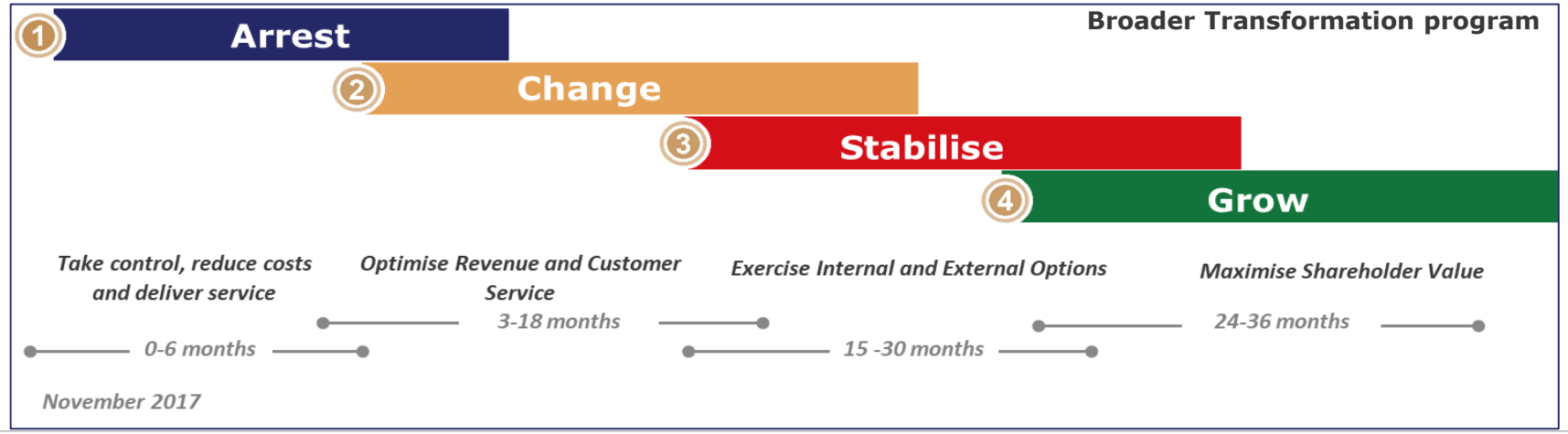
1. Ratios Driven Headcount Rationalisation
2. OD Spans and layers

Supply Chain Transformation

1. Review policy
2. No-Sacrifice BBBEE strategy
3. Aggressive SCM strategy to drive costs down.

SAAT Business Process Transformation

1. Shift work for Labour
2. Logistics review
3. Business process
4. Aircraft Repair Turnaround



LTTS: Progress to date

	Achievements	Next steps
Revenue Stimulation and Network Optimisation	1. Route optimisation initiatives implemented with domestic capacity reduced to focus on profitable routes and Full Service Carrier (FSC) market. 3 of 4 domestic routes profitable at route level 2. London frequency reduced leading to C4 profit in Q2 for first time in a decade 3. Central Africa route ceased to arrest losses 4. 4 narrow body aircraft moved to Mango to address growing Low Cost Carrier (LCC) market with positive overall results. Exited 5 wide-body aircraft	1. Increased aircraft utilisation under review for implementation will lead to additional capacity and opportunity for increase in Charters. 2. Alternate routes under review to optimise asset use. West Africa and North America present attractive opportunities 3. Mediation plan for the loss making Hong Kong route 4. Current Fleet review concluded and leases re-negotiated
Supply Chain Transformation	1. New Procurement Policy implemented to ensure tighter control of company spend. 2. Supply Chain organisation cleaned up with number of suspensions 3. Total cost savings to date through specific procurement interventions R400m of R1.6bn target. Key categories: energy, passenger revenue cost, MRO cost and aircraft leases	1. Full contract review completed and established a contract database to highlight spend categories 2. Cross functional teams established to focus on cost reduction and revenue leakages. 3. Revenue leakage and cost containment centre of excellence
Organisational Design	1. 294 excess Cabin Crew: VSP's, early retirements and sabbaticals options offered (total 71 exits). Section 189 process started on 1 November to address remaining. 2. 122 excess Flight Deck Crew: Pilots released on contract, took early retirement and sabbaticals. 3. Section 189 process has been concluded at subsidiary Airchefs	1. Definition of new operating model completed 2. OD process kicked off and final project plan being drafted 3. Engagement with Labor Workgroups ongoing

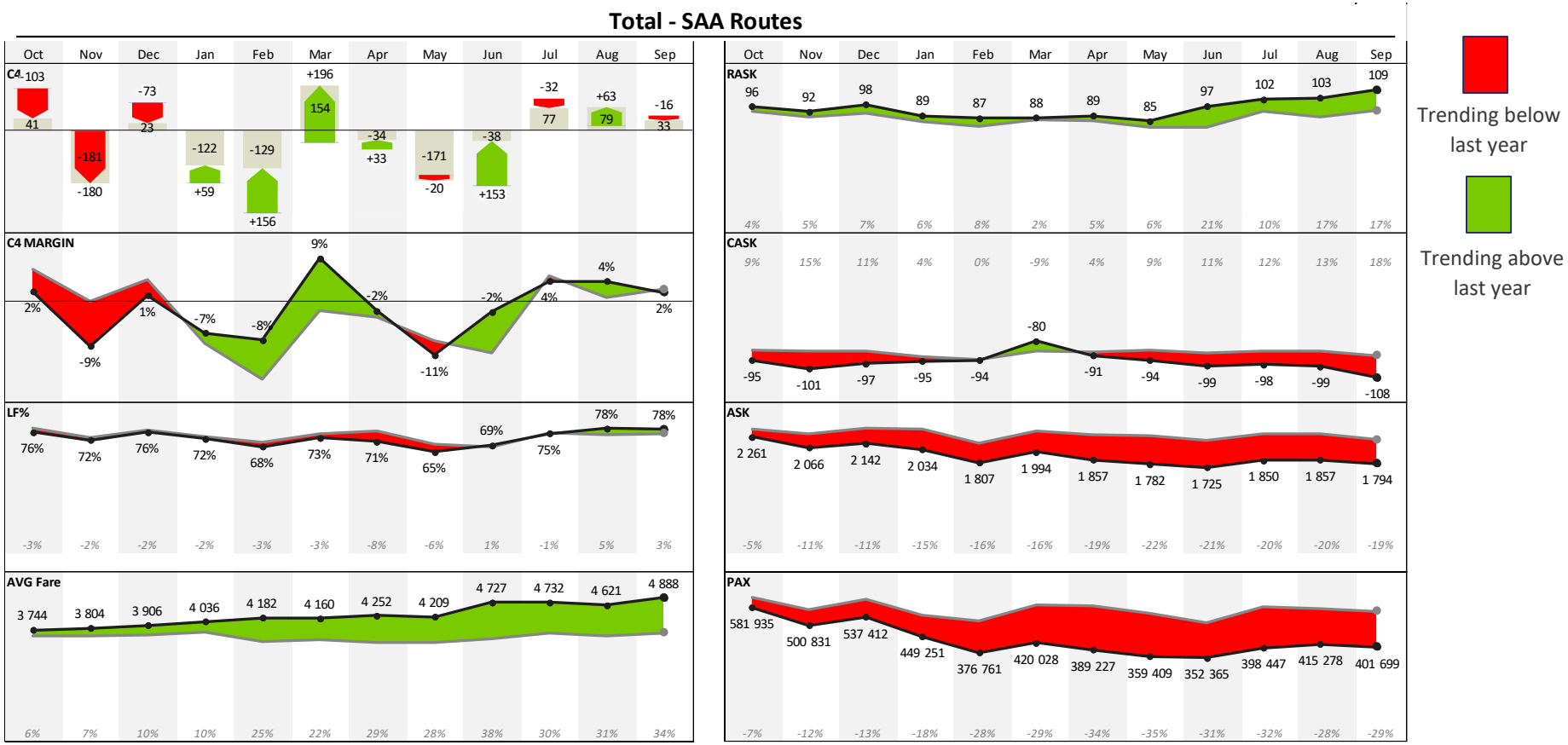
SAA Technical Business Transformation

- SAA T turn–around times to return aircraft to operation remains one of our biggest internal challenge and threat to achieving our performance objectives
- SAAT is constrained by serious organisational and operational challenges and inefficiencies

- SAAT transformation plan has been co-developed with Airbus
- Four A340-300's outsourced abroad for heavy checks and nine (9) more are being for maintenance outsourcing
- Procurement issues addressed: Empty bins reduced

- Further wide-body maintenance outsource to make room for narrow-body capacity
- Assessment of introducing shift work to open up capacity
- Various key positions in logistics, engineering and others being filled

OVERALL NETWORK Improvements



Source: RCE

Focus going forward is to reduce CASK, whilst continuing to improve RASK

Source: Management reports

ROUTE PERFORMANCE (by market)

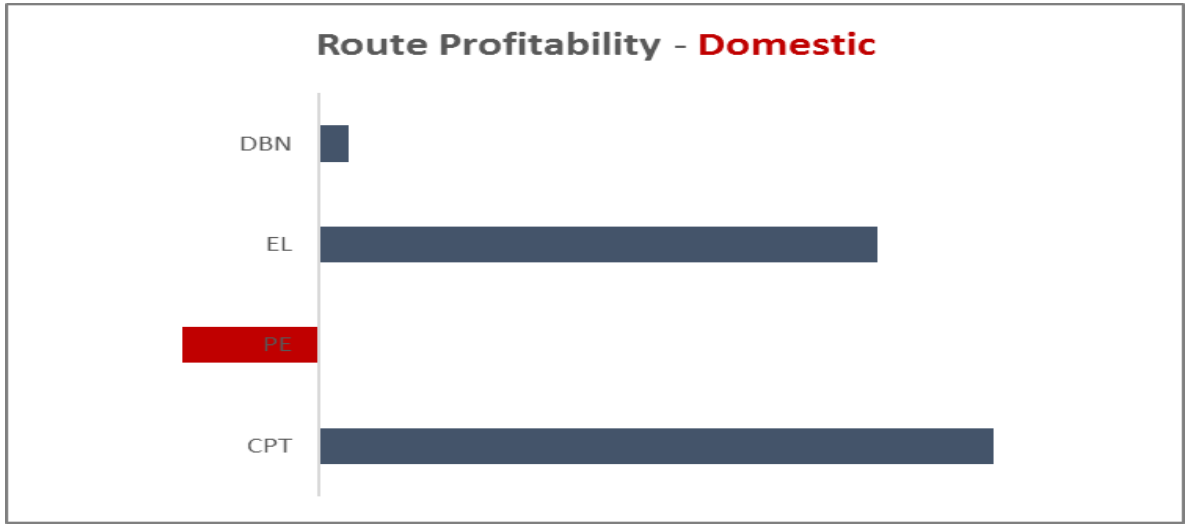
Positive signs of turnaround in the Domestic market -3 of the 4 routes yielding profitability at route level

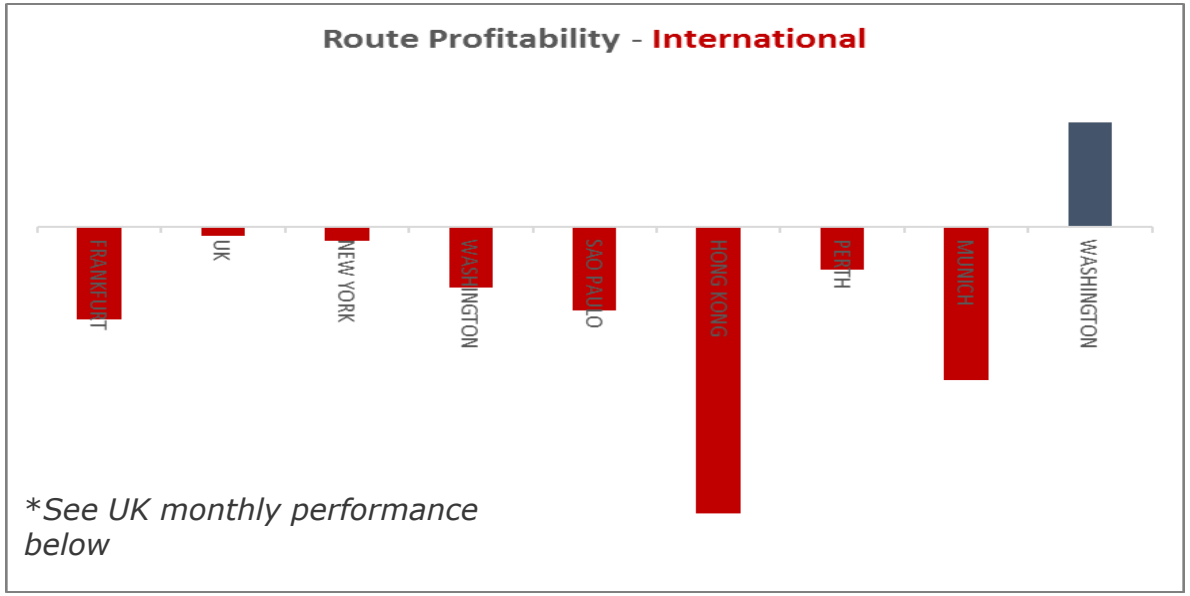
Strong performance in Regions - Despite reduction in capacity relative to budget, strong performance at C4 level

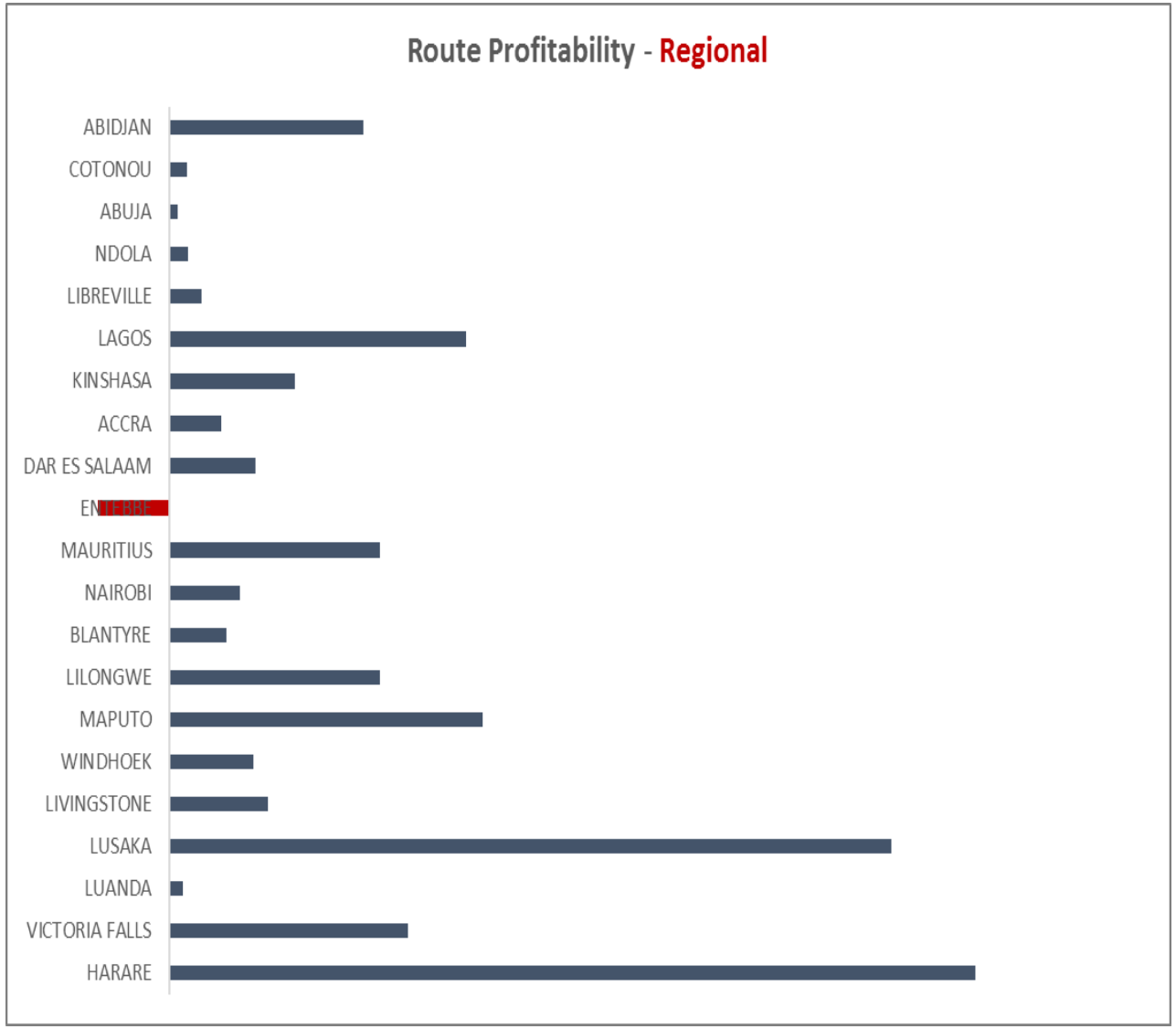
Extremely tough environment in International market - Competition and high fuel costs are major challenges

Total income	R1.9 billion	R3.3 billion	R5.9 billion
Operating profit (C4)	R133 million	R570 million	(R649 million)
Other costs	(R421 million)	(R417 million)	(R734 million)
Net profit (C5)	(R288 million)	R153 million	(R1.4 billion)

ROUTE PERFORMANCE at C4 level

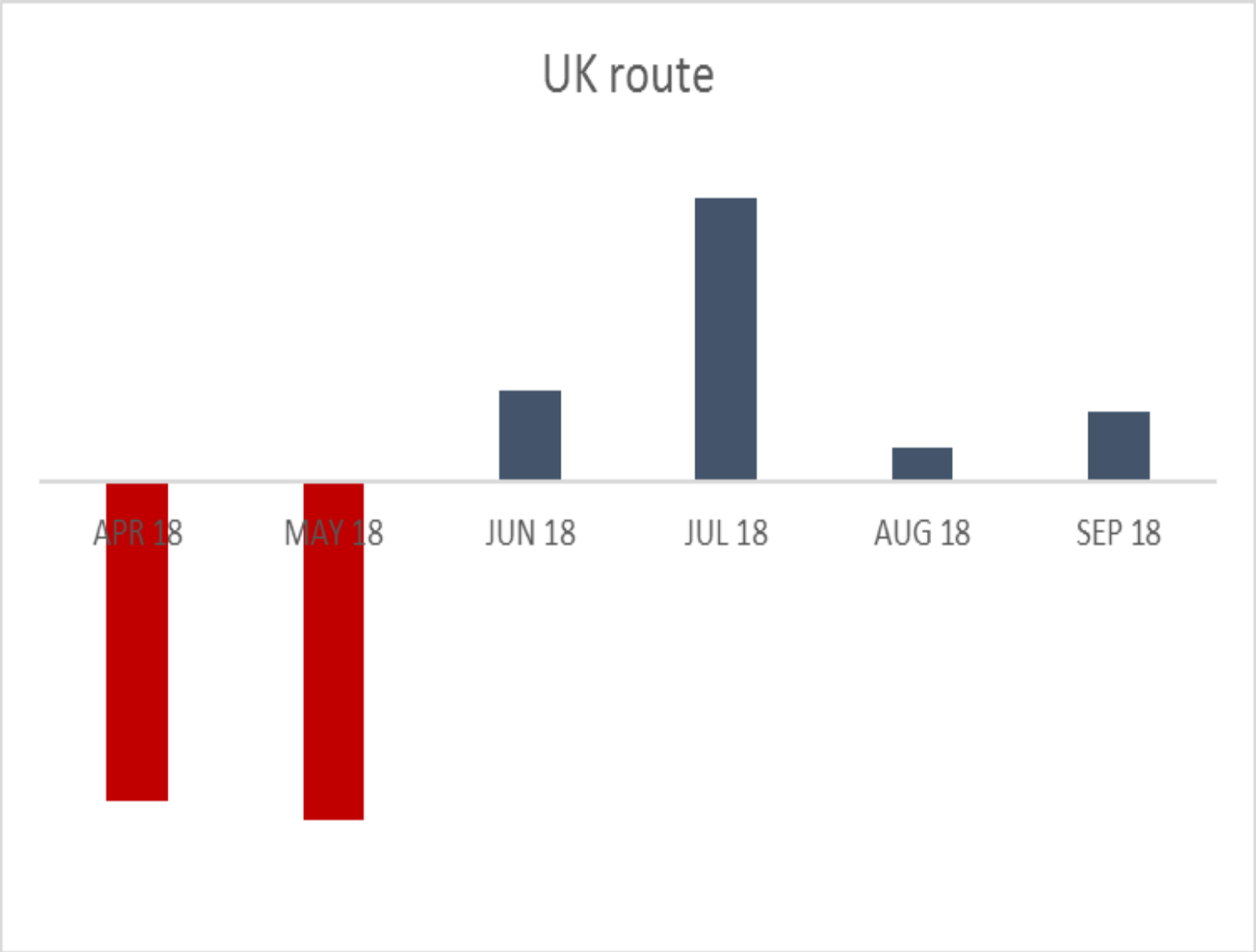






Source: Management reports

ROUTE PERFORMANCE at C4 level



Source: Management reports

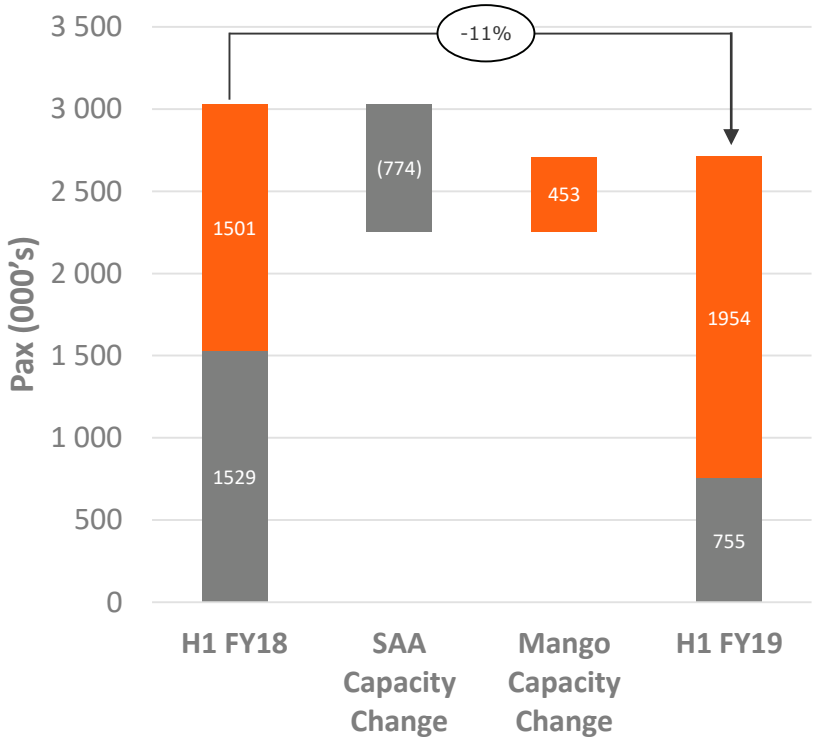
1. London Heathrow route optimisation has resulted in positive GP at route level for the first time in 10 years

2. International routes have suffered from:

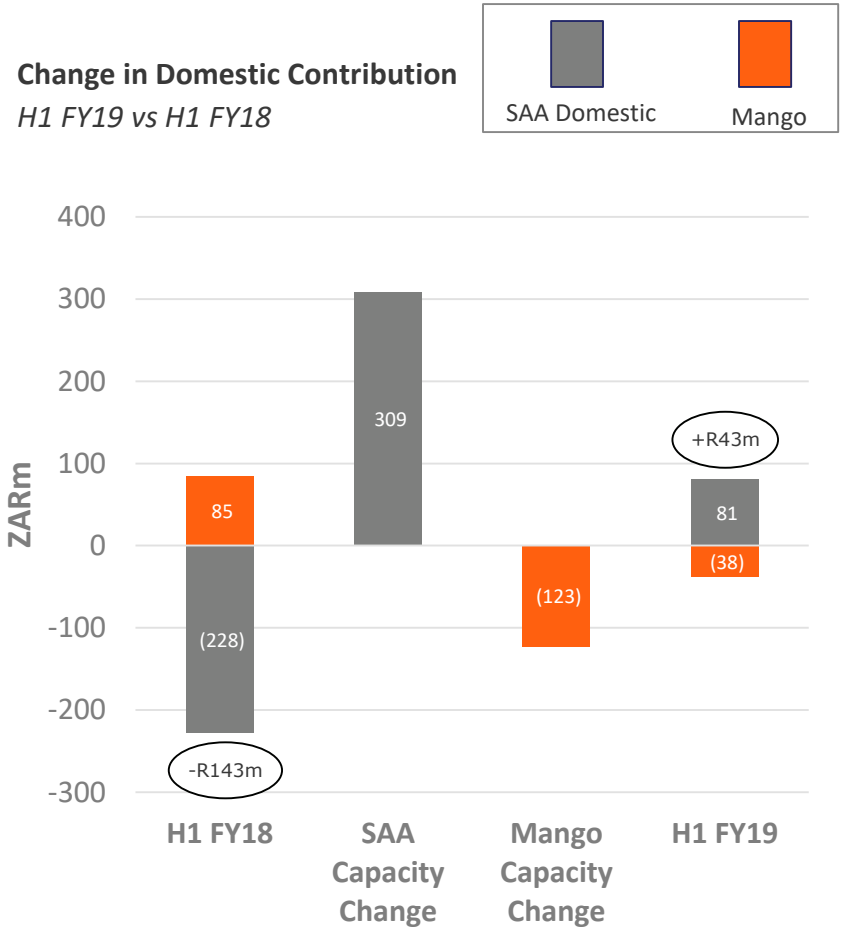
- *High crude oil prices*
- *Increased competition, and*
- *Negative publicity relating to SAA*

Capacity shift to Mango has resulted in a reduction in total domestic pax of 11% YTD but in a contribution improvement in domestic operations of R186m from -R143m to +R43m

Change in Domestic Passengers
H1 FY19 vs H1 FY18



Change in Domestic Contribution
H1 FY19 vs H1 FY18



While overall domestic passengers have declined by 11% between H1 FY19 and H1 FY18, there has been a marked improvement in contribution as a result of the shift from –R143m to +R43m

Note: Mango contribution assumed as EBIT – Other costs

Half Year Performance Results
September 2018

Business performance against Corporate Plan – September 2018

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Quarter 2 delivered strong network performance for SAA Airline

- Revenue passengers 4% ahead of plan due to network changes;
- Revenue average seat kilometer 6% ahead of plan due to price increases;
- Average load factor 1% ahead of plan;
- Average seat kilometer -3%; and
- Average fares 10% ahead of plan.

Operating cost 2% ahead of plan

- Cost average seat kilometer is 5% lower than plan as result of forex;
- Energy cost is 12% more that plan due to oil prices;
- Labour cost 3% below plan – only filling critical vacancies; and
- Aircraft maintenance cost is 30% lower than plan due to lower activity and challenges at SAAT.

Group Income Statement for the period ended 30 September 2018

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Rm	YTD ACTUAL	YTD BUDGET	VAR	YTD PRIOR YEAR	VAR	FULL YEAR FORECAST	FULL YEAR BUDGET
Total income	13 589	12 932	5%	14 608	-7%	27 610	26 943
Operating costs	(15 136)	(15 405)	2%	(15 552)	3%	(31 326)	(30 313)
Energy	(3 993)	(3 577)	-12%	(3 549)	-13%	(8 470)	(7 140)
Labour	(3 166)	(3 263)	3%	(3 042)	-4%	(6 397)	(6 369)
Aircraft Maintenance	(1 392)	(1 982)	30%	(2 268)	39%	(3 273)	(3 868)
Aircraft Maintenance	(1 810)	(1 982)	9%	(2 306)	22%	(3 615)	(3 868)
Less: Forex adjustments included in Aircraft Maintenance Costs	(418)	-	>100%	(38)	>100%	(342)	-
Other Operating Expenses	(6 584)	(6 583)	0%	(6 694)	2%	(13 187)	(12 936)
EBITDA	**(1 547)**	**(2 474)**	**37%**	**(945)**	**-64%**	**(3 717)**	**(3 370)**
Depreciation, impairment & other	(431)	(462)	7%	(460)	6%	(713)	(913)
EBIT	**(1 978)**	**(2 935)**	**33%**	**(1 404)**	**-41%**	**(4 429)**	**(4 283)**
Hedging gains/ losses	15	-	>100%	(14)	>100%	15	-
Foreign exchange gains/ losses	225	32	>100%	76	>100%	300	32
- Realised forex	(269)	0	>100%	74	463%	(269)	0
- Unrealised forex	911	32	>100%	41	>100%	911	32
- Forex adjustments included in Aircraft Maintenance Costs	(418)	-	>100%	(38)	(0)	(342)	-
OPERATING PROFIT (LOSS)	**(1 738)**	**(2 903)**	**40%**	**(1 342)**	**-30%**	**(4 115)**	**(4 251)**
Net finance income (costs)	(537)	(541)	1%	(745)	28%	(1 161)	(1 005)
PROFIT (LOSS) BEFORE TAX	**(2 275)**	**(3 444)**	**34%**	**(2 087)**	**-9%**	**(5 276)**	**(5 256)**
Taxation	31	(0)	>100%	(13)	>100%	8	78
NET PROFIT (LOSS)	**(2 244)**	**(3 444)**	**35%**	**(2 100)**	**-7%**	**(5 267)**	**(5 178)**

Group Cashflow Statement for the period ended 30 September 2018

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	Rm
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash receipts from customers	13 628
Cash paid to suppliers and employees	(16 643)
Cash generated by operations	**(3 015)**
Interest received	30
Dividends received	-
Realised foreign exchange on payments & settlements	(269)
Option premium spend	(26)
Other realised hedging cashflow	(4)
Taxation received (paid)	31
Other (movement in retained earnings relating to period 13 adjustments)	0
Net cash inflow (outflow) inflow from operating activities	**(3 253)**
CASH FLOWS FROM INVESTING ACTIVITIES	
Additions to property, plant & equipment	(108)
Additions/ Disposals to intangibles	(10)
Release from security deposit	(2)
Payment of security deposits	(13)
Net cash inflow (outflow) from investing activities	**(133)**
CASH FLOWS FROM FINANCING ACTIVITIES	
Increase/(decrease) of term loans	5 000
Interest paid	(564)
Net cash inflow (outflow) from financing activities	**4 436**
Foreign exchange effect on cash and cash equivalents	391
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**1 441**
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	**1 071**
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**2 512**

SAA current performance September 2018

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R'mil	Budget	Actual	Var
Revenues	12 392	13 589	5%
Operating cost	15 405	15 136	2%
Operating loss	**(2 903)**	**(1 738)**	**40%**

Cash and cash equivalents (31 October)	1 989
Free cash available (31 October)	456
Restricted funds (31 October)	1 808

Cash flows : October - March

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R'mil	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19
Operational Inflows	**3 011**	**2 580**	**2 393**	**2 037**	**2 416**	**2 534**
Operational Outflows						
Accounts payable	-998	-810	-723	-728	-746	-728
Fuel, leases, maintenance reserves	-1 135	-1 126	-1 097	-1 079	-1 079	-1 065
Payroll	-303	-370	-237	-237	-237	-237
Regulatory – ACSA, SARS	-207	-245	-252	-200	-200	-200
Once Offs	-145	-176	-31	-31	-409	-31
Interest	-97	-53	-174	-98	-54	-136
Other airlines incl IATA	-662	-596	-596	-516	-566	-596
	-3 547	**-3 376**	**-3 110**	**-2 889**	**-3 290**	**-2 992**
Net outflow - Rm	**-536**	**-796**	**-718**	**-852**	**-874**	**-458**

Forecast cash position 31 March 2019

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	Rm
Free cash 31 October 2018	456
Operational inflows	14 970
Operational outflows	(19 205)
Net position 31 March	(3 779)

R5 b recapitalization will repay exiting R5 b debt (bridging finance)

Requirement is to procure R 2.0 b by 1 December and R 1.5 b in February

Immediate impact and consequences of negative news

SOUTH AFRICAN AIRWAYS
A STAR ALLIANCE MEMBER

- Defaulting on any one loan to SAA would trigger legal terms for immediate repayment on the rest of its debt.
- Low staff morale
- Not an employer of choice – can't attract the required skills
- Creditors want to reduce payment terms, guarantees and prepayments e.g. Total, Shell, BP
- Organisation loses it's power to negotiated better terms
- Pressure place on our already stressed cash flows
- Doing business with SAA becomes high risk
- Banks don't want to finance SAA

Quantifying the impact

SOUTH AFRICAN AIRWAYS
A STAR ALLIANCE MEMBER

- **Forward bookings** – Previously, our international markets lost significant revenues of more than ZAR 500 million in forward sales being diverted to other airlines. Cargo also impacted.
  - It took us a long time to win back the confidence of the markets, and we have not fully recovered and the trade had already expressed their concerns about committing to SAA.

- **Fuel** - Our exposure for guarantees could be up to USD25m or more, depending on the fuel price.
  - TOTAL have already indicated reducing terms from 21 days to 7; and
  - Shell have requested a meeting and may follow with a similar demand.

- **Bankers** – Negotiating for the R3.5bn loan not possible anymore as banks require additional commitments from the shareholder

Solvency & Liquidity Challenges

The approved Corporate Plan assumed capital injection of R21.7bn

Liquidity Requirements

- R9.2bn short term loans maturing in March 2019
- R5.0bn banks short term loan maturing in November 2018
- R7.5bn working capital needed in December 2018 (R3.5 bn) & from March 2019 (R4.0 bn)

Challenges

Government:

- Significant budget shortfalls on fiscus
- Competing funding requirements from Gov Departments and SOCs e.g. ESKOM, SABC, SAX
- Inability to commit to multi-year appropriation

SAA faces a number of liquidity risks:

- Going Concern issues
- Potential reckless trading
- 6 month term supplier contracts
- Suppliers and partners demanding up-front payment
- Negative media affecting global bookings

Management has evaluated and modelled likely funding scenarios for the implementation of the Corporate Plan for evaluation

	1 Additional credit lines from banks	2 Treasury funds shortfall only	3 Treasury funds existing debt shortfall only
Description	1. R3,5B cash shortfall to March 2019 2. R4B shortfall for FY20 financial year 3. Includes restructuring of existing debt	1. R7.5B cash shortfall through government appropriation 2. R9.2B debt maturing in March 2019 rolled over	1. Shareholder settles R9.2B debt obligation immediately 2. Funds remaining cash shortfall of approx. R7.5B
Pros	1. Provides short term breathing space to execute against plan	1. Eliminates/ reduces future cash burden on SAA 2. Enables focus on transformation	1. Eliminates/ reduces future cash burden on SAA 2. Enables focus on transformation
Cons	1. Additional debt burden to SAA 2. SAA has a much lower debt capacity 3. Finance costs prohibitive 4. Will require additional multi-year government guarantees to be committed to ensure path to debt reduction		

The Joint Oversight Forum has been set up to address liquidity and capital challenges at SAA

Background

Set up in March 2018 as a joint forum between National Treasury (Shareholder at the time) and SAA Board for a period of 6 months

Continues under the Department of Public Enterprises since change in administration of SAA in August 2018

Purpose

The Oversight Forum seeks to ensure that the conditions for successful strategic recovery of SAA are in place and further endeavour to enhance SAA and DPE collaborative efforts

Objectives of Forum

- Address the immediate liquidity challenges facing SAA
- Determine the long term funding requirements of SAA
- Determine the optimal capital structure for SAA
- Create the enabling environment for strategy implementation
- Determine mechanisms to implement the optimal capital structure and funding model for SAA

FY2020 – 23 Corporate Plan Update

FY20 – 23 Corporate Plan Review

A number of key internal and external planning assumptions have changed since the Corporate Plan approval, resulting in the deterioration of the financial performance at net profit level

- Foreign exchange
- Oil prices
- Network assumptions
- Funding and capital structure
- Restructuring progress

In order to mitigate the effects of the changing assumptions on the Corporate Plan, a number of remediation initiatives have been evaluated , that will recover the plan

- Accelerated cost containment and revenue assurance measures
- Foreign Exchange revenue recovery
- Schedule & fleet optimisation
- Charters
- Alliances/ JVs
- Other

In order to mitigate the effect of the exogenous and endogenous factors a number of remediation initiatives have been evaluated …

Initiative	Description	Revenue impact	Cost impact
FX revenue recover	Increase in number of pax as SA becomes more viable/attractive destination for foreign travellers Increase in yields from shift of focus to non-SA markets with hard currencies Higher competitiveness vs international competition	Assumed recovery of ~50% of forecasted ZAR decline Results in estimated revenue increase of ~0.3–1.1% p.a.	-
Schedule optimisation	Reduction in turnaround times at various international destinations (IAD, PER, HKG) Increase in utilisation of aircraft Better aircraft allocation to routes and increased utilisation of 2-engine WB	~1.5% reduction in revenue due to decrease in capacity and impact on existing connections banks	Improvement in operating costs through better utilisation of more route efficient aircraft
Fleet alignment	Reduction in number of aircraft required to operate network through increased utilisation	-	Reduction in ownership costs through smaller fleet (aircraft depreciation reduction)
Alliances / JVs	Enter into alliance/JV agreements with other carriers on selected routes	Assumed at ~$4m per JV based on current on-going MK negotiations	JVs share costs & revenue on specific routes no matter which operator is doing the actual flying Anti-trust immunity maximising opportunity for efficiency gains, reducing risk
Charters	Increase number of ad-hoc, scheduled and ACMI charters Assumed 2x aircraft, 200 FH pm for 6 months each	Increased revenue through additional (profitable) charter activity Net benefit estimated at ~$1,000 per FH	Improved fixed costs absorption

Audit Findings

SAA has seen a significant increase in irregular, fruitless and wasteful expenditure compared to FY2016

Expenditure	FY2017 Quantum	Root Causes
1. Irregular	• R125.9 million	• Interest on late payments • Lack of planning on aircraft returns • Delays in finalising contracts
2. Fruitless and wasteful	• R40.4 million	

Progress in addressing irregular, fruitless and wasteful expenditure

- Reviewing the Supply Chain Management (SCM) Policy
- Capacitating the SCM department
- Undertaking refresher training for the rest of the business
- Consequence management where appropriate

Irregular expenditure mainly resulted from delays in concluding contracts, whilst fruitless and wasteful expenditure was largely a result of late payments

The Board and management acknowledge the severity of the AGSA findings …

2016/17 Qualification Areas	Audit Finding(s)
1. Property, aircraft and equipment	• SAA did not adequately review useful lives and residual values of property, aircraft and equipment in accordance with IAS 16
2. Rotables	• Existence of some rotables could not be verified; and • The completeness of the rotables on the fixed asset register could not be established
3. Property, plant and equipment (PPE)	• SAA did not assess its PPE for impairment in terms of IAS36
4. Inventory	• The key assumptions applied by SAAT in calculating net realisable value were not supported by sufficient appropriate audit evidence • Existence of certain inventory items could not be verified
5. Maintenance costs	• Maintenance costs recognised in the incorrect period • Maintenance costs not reflecting on Statement of Comprehensive Income • Incorrect exchange rates used • Prepayments charged to the Statement of Comprehensive Income
6. Irregular expenditure	• SAA did not establish adequate controls to maintain complete records of irregular expenditure
7. Fruitless and wasteful expenditure	• SAA did not establish adequate controls to maintain complete records of fruitless and wasteful expenditure
8. Material uncertainty related to going concern	• Material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern

… and a detailed project plan is being implemented to address these findings

2016/17 Qualification Areas	Root Cause(s)	Target Date	Progress update	Resolution Status
1. Property, aircraft and equipment	• Annual review of useful lives and residual values on owned aircraft not done at component level • Lack of clarity on property ownership between SAA & SAAT impacted accuracy of allocation of adjustments	31 May 2018	Owned Aircraft and improvements on leased aircraft were assessed in terms of useful lives and residual values as part of the 2018 audit.	This item has been cleared from an audit perspective. It has not reoccurred as an issue during the 2018 audit.
2. Rotables	• Stock counts not done • Stock receipt on both Memis & SAP not done	14 June 2018;	A 100% stock count has been performed.	The stock count was completed as part of the 2018 audit. Full counts to be performed annually going forward
3. Property, plant and equipment (PPE)	• Carrying value of assets more than recoverable amounts • Accelerated depreciation on some assets	Original date:14 June 2018 Finalisation date: 30 June 2019	A service provider has been appointed to count and tag all assets, record them in a register and evaluate the remaining useful life.	While the project is proving to be greater than initially thought, it is continuing according to plan .and the 2019/20 audit should not reflect this as an audit finding.
4. Inventory	• No records of policy being applied	Original date: February 2018 Revised date: 30 Nov 2018	- Policy has been submitted to the November Board meeting for approval - Inventory count was concluded	The policy for stock obsolescence has been drafted , has Exco approval and is awaiting final Board approval. The draft policy has been applied in the current year.
5. Maintenance costs	• Accruals not made • Differences between SAA & AGSA on treatment of restoration costs	8 June 2018	Invoices for work done but which was not yet invoiced by year end have been accumulated and the expenses and accrual accounted for appropriately.	These items have been fully addressed and are not an issue in the 2018 audit

… and a detailed project plan is being implemented to address these findings

2016/17 Qualification Areas	Root Cause(s)	Target Date	Progress update	Resolution Status
6. Irregular expenditure	• Lack of planning on aircraft returns • Delays in finalising contracts	January 2018 Revised date: 31 March 2021	the 2017/18 and 2016/17 review has been completed and the figures have been included in the annual financial statements for 2017/18 FY. Management has to review all contracts entered into from financial year 2012 to 2018 as per the AGSA's recommendations.	While management have addressed this issue to ensure compliance going forward, the historical situation cannot be changed. It is being reviewed in order to have a full record of irregular expenditure over time. This is a task that takes a great deal of time to complete.
7. Fruitless and wasteful expenditure	• Late payments	April 2018 Revised date: 31 March 2021	The same comment as for irregular expenditure applies	The same comment as for irregular expenditure applies.
8. Material uncertainty related to going concern	• Under capitalisation • Accumulated losses	September 2018 Revised possible date: 28 February 2018	In progress – R5b recap confirmed. Need to extend maturity of loans and access further funding	Management continues to liaise with the shareholder and lenders to resolve this situation for 2018.

2018 Audit Update:
2017/18 Audit process is substantially complete however the final audit opinion will only be given once SAA's going concern status is confirmed

Forensic Investigations

Forensics Investigations

- **The previous SAA Board had commissioned four forensic investigations on a number of areas of SAA's Operations**
  - MJS forensics,
  - ENS Africa,
  - EY and
  - Open Water.

- **The forensic reports were handed over to the then SAA Board**

- **The reports were handed over to the current Board in November 2017 for implementation**

- **The current Board established the Board Forensic Task Team ("BFTT") which is constituted by some board members and SAA executives**
  - BFTT reports to the Board on the progress of material investigation and oversees the implementation of the recommendations contained in the forensic reports.

- **The Board also appointed Cliffe Dekker and Hofmeyr ("CDH") to assist with the implementation of the recommendations**

Forensic Reports

	1 ENS	2 MJS Forensic	3 EY	4 Open Water
Scope	• ENS investigated issues of Profitability, procurement and governance issues • The report covers a number of areas of the business from revenue leakage, internal control systems and mechanisms, drivers of operational costs, international business operations, and procurement processes and makes observations	• The investigation looked into the tender process to source a transaction advisor. BNP Capital was selected. • In their report, MJS pointed to potential misconduct on the part of the CFO and other employees involved in the transaction and questioned the role of the previous Board.	• The scope of investigation was limited to the procurement and contract management practices at SAA and three of its subsidiaries. • Major contracts, e.g, KWE logistic contract, Airbus swap transaction, SITA IT contract, Swissport, Reshebile security contract and AAR/Jm Aviation contract	• The investigation focused on Operational Procurement and the awarding of Long Term Contracts Component Support at SAAT. • The report covers the components tender, logistics, paint, tyres and the purchase and sale of ground power units (GPU) amongst other aspects in the scope.
Findings and Actions	• Most of these areas of observation are being addressed through the turnaround strategy as well as business as usual management actions. • Two employees were dismissed and two resigned.	• BNP Capital has been reported to law enforcement agencies in line with requirements of the law. • Two employees were dismissed and one resigned.	• Most of the observations made were responded to by management and actions to correct the operational systems of internal control are being implemented. • One employees resigned	• Twenty two employees were found guilty and received final written warnings. One employee was dismissed. • To the extent that there is possible acts of contraventions of the law, the matter is reported to the law enforcement agencies.

New investigations and involvement of the SIU and the Hawks

- We have appointed Grant Thornton, Fundudzi, and Gobodo Forensics to conduct forensic investigations on the SITA AERO contracts, theft of Utility Loading Devices ("ULDs") and the procurement and advertising in the New Age newspaper. The investigations are focused on the IT, Procurement and Cargo divisions of SAA.

SIU and Hawks

- Due to the fact that SAA does not have its own forensic capacity, we have approached the SIU and requested them to second experienced forensic investigators for a period of twelve month. We have also requested them to conduct a full scale investigation on procurement issues.
- The Hawks are setting up a team of specialist investigators to address any form of possible criminality that may have been involved

End