

DPE Winter School 2009

SOUTH AFRICAN AIRWAYS

Content

1. Description of Activities

2. Recent Performance

3. Current and Future Challenges

Our Vision, Mission, Values

Vision

An African airline with global reach

Mission

To deliver sustainable profits and to grow our market share through world class service to our customers internally and externally

Values

- Safety
- Valuing Our People
- Customer Focused
- Accountability
- Integrity
- Excellence In Performance



SAA's Strategic Value

The geographical location of South Africa necessitates air services connectivity for the normal functioning of the economy and trade and industry.

- **SAA's mandate** is to be the African Airline with global reach
- Through its **established network** SAA provides:

Intercontinental connections to major cities of strategic interest to South Africa

- ✓ SAA accounts for +/- 38% of international arrivals
- ✓ Through STAR offers 17,600 daily flights serving 943 destinations in 159 countries



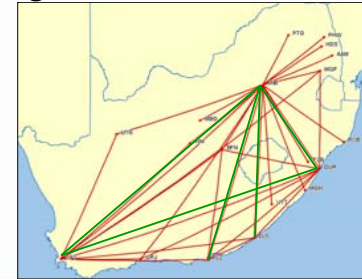
Connections to key cities within Africa

- ✓ SAA accounts for +/- 49% of Africa arrivals from the 19 cities SAA serves directly
- ✓ SAA creates connectivity between Africa, South Africa and International destinations



Intensive domestic schedule and connectivity

- ✓ SAA has the most extensive domestic schedule which is enhanced by its partners SAX and SA Airlink
- ✓ SAA moves 60% of all air cargo in South Africa



SAA's Strategic Value

SAA contributes to and supports the broader National Governmental goals

Employment

- ✓ SAA and its subsidiaries employ 9489 people full-time
- ✓ 1600 contractors are dependent on SAA for part-time employment
- ✓ Training and development of technical aviation skills (pilots, crew, technicians) which would not have been there otherwise
- ✓ Contribute to indirect employment in tourism industry (Travel agents, hospitality)

Economic growth

- ✓ Cargo is a key enabler for export market: Time critical and high value goods
- ✓ Annualised payments of R18.1 billion to suppliers between April and September 2008 alone
- ✓ 45% (R609m) of ACSA's aeronautical revenue was paid by SAA which enabled it to expand infrastructure and increase employment
- ✓ Contribute to domestic spending by paying +/-R2b in direct salaries
- ✓ Promoting South Africa as a destination

Africa footprint

- ✓ Contribute to the development of the safety aviation standards in Africa
- ✓ Assist with aviation liberalisation of the continent - intra Africa aviation industry,
- ✓ Support South African companies with an Africa footprint by providing reliable network and schedule

Customer satisfaction trends: Upward trend continues although not reaching the 80% target in all areas yet

Customer Satisfaction Surveys (February 2009):

- Customer satisfaction (77%), 2% increase year on year
- Customer satisfaction – Dom 78% (upsurge); Africa 76% and International 77%
- The **airport services** satisfaction level is 77%
- **On-time performance** improved by 26% and this is a contributing factor to increased satisfaction.
- The overall **cabin service** satisfaction is 78%
- **Crew service** has increased by 2% to 89%

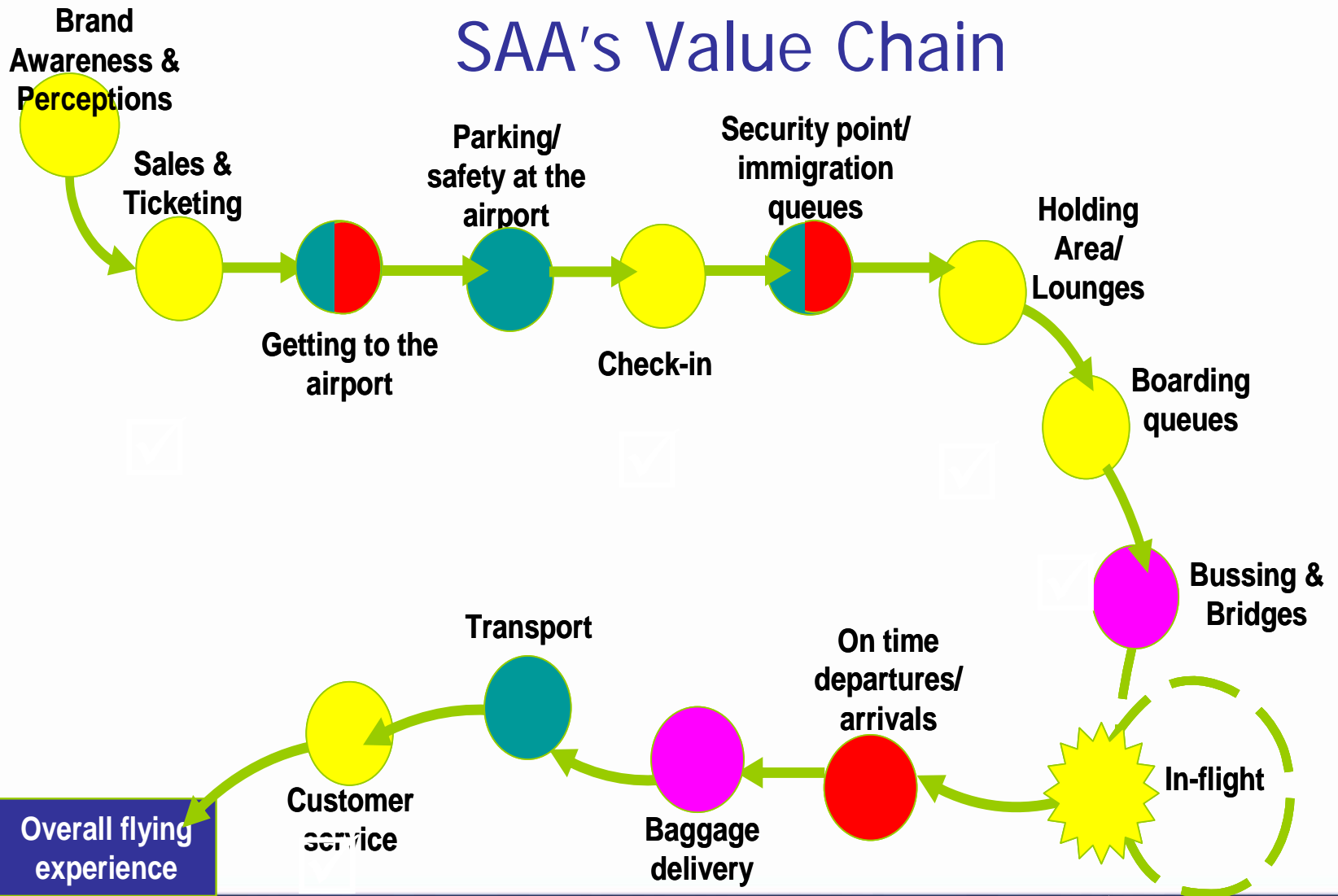
Star Alliance CSS Q4/08

- The overall flight satisfaction of SAA with Star Alliance rates at 74%, which is under the Star Average of 77%. The main reason for the shift was the lounge facilities and transfer service

Skytrax results

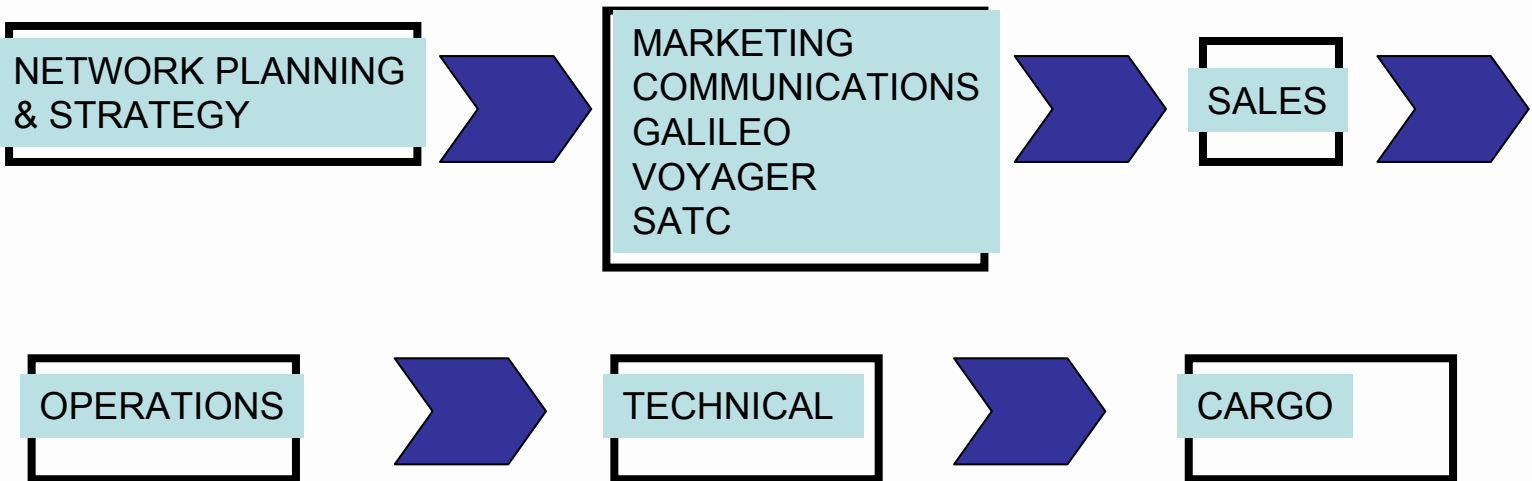
- SAA was no 11 for business class and 14 for economy class of 167 airlines. 7th consecutive year: Best Airline in Africa. Crew ranked 14 overall in the world.

SAA's Value Chain

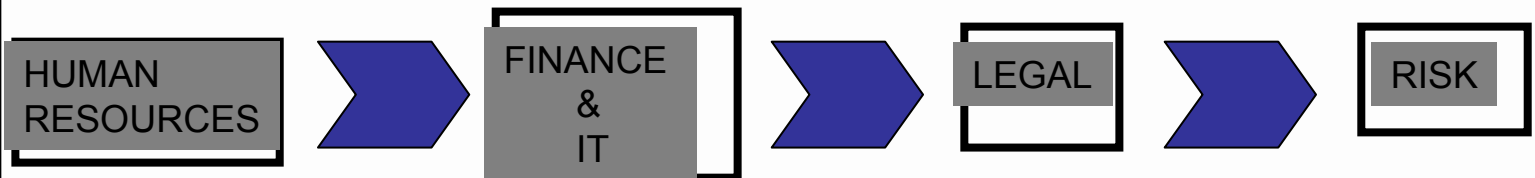


The SAA Operating Model

CORE BUSINESS DIVISIONS

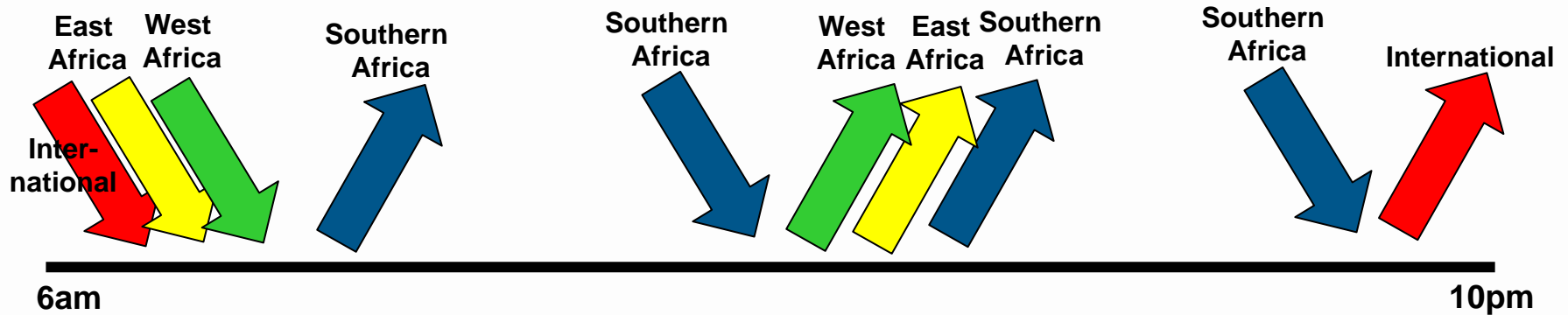


SUPPORT DIVISIONS



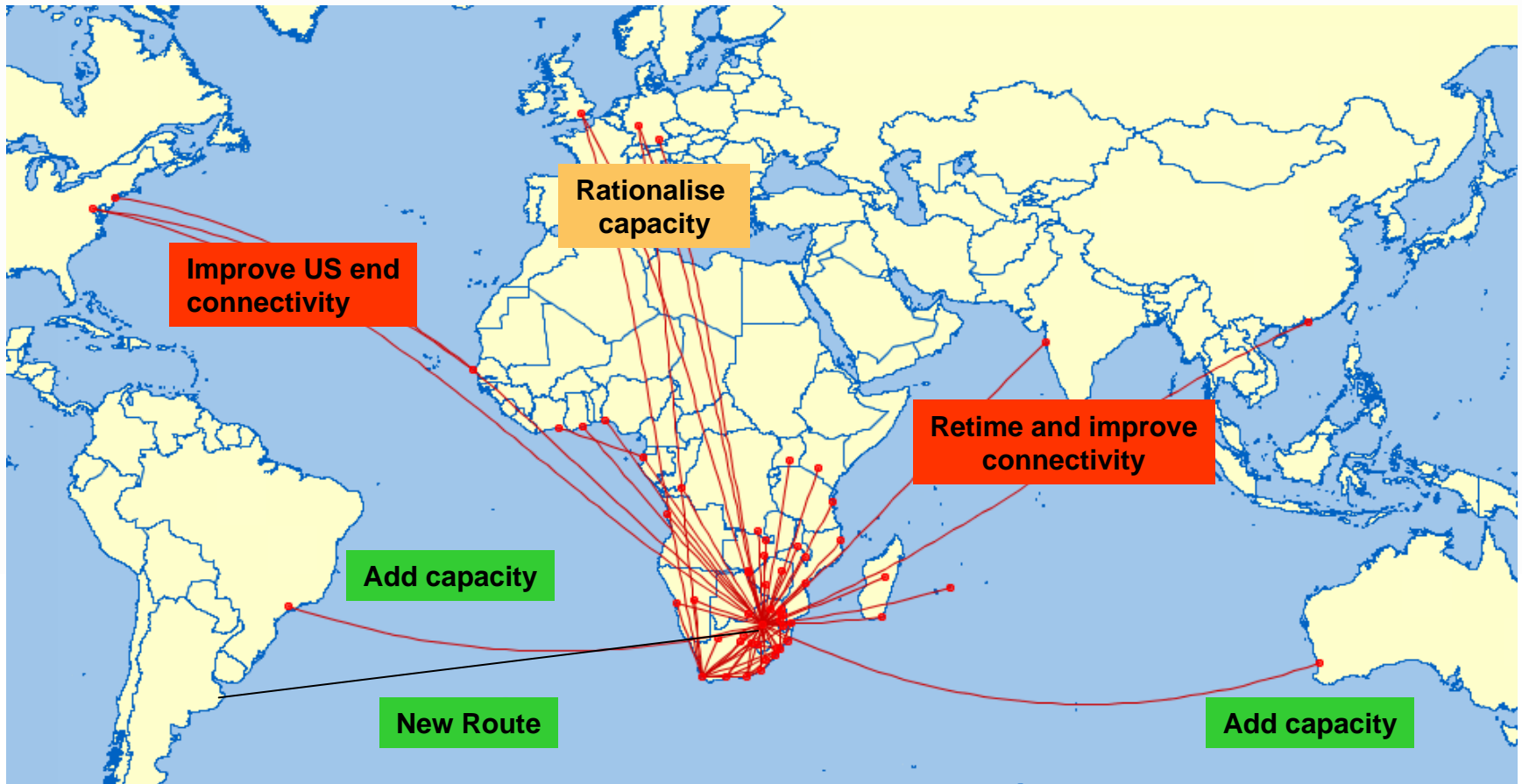
Network Strategy

- Our network strategy is focused on:
 - Being an African carrier with global reach
 - Enhancing our JNB hub
- In the absence of new aircraft we have re-aligned capacity to more profitable routes
- We are continue to 'tighten' flights in our bank structure (below)



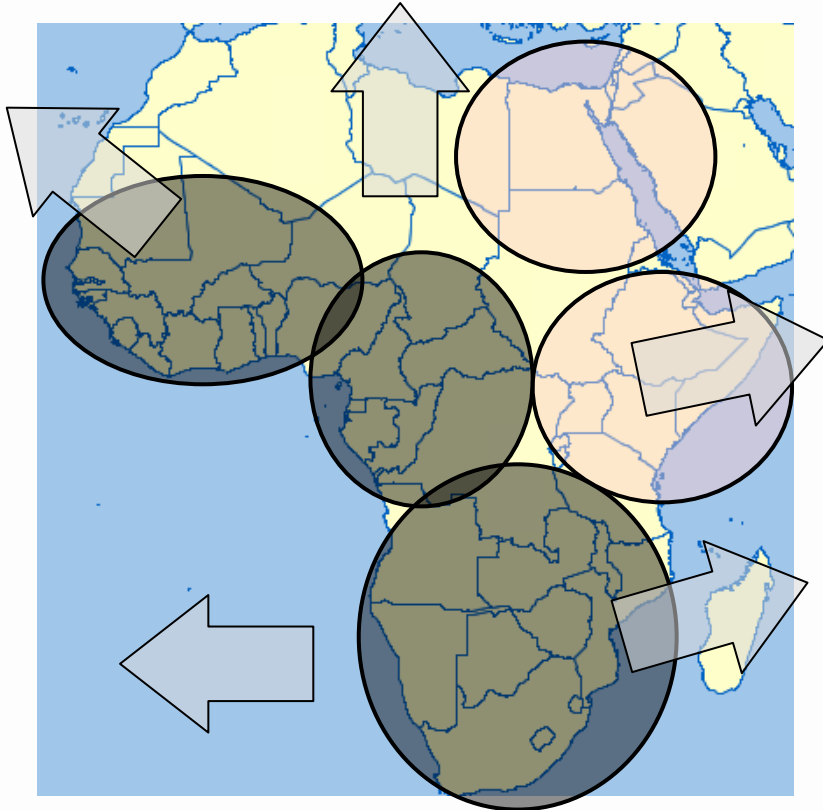
International Network

Concentrates on major gateways in each continent supported by strong alliance partners



Africa: Key Focus Area

SAA Sphere of Influence



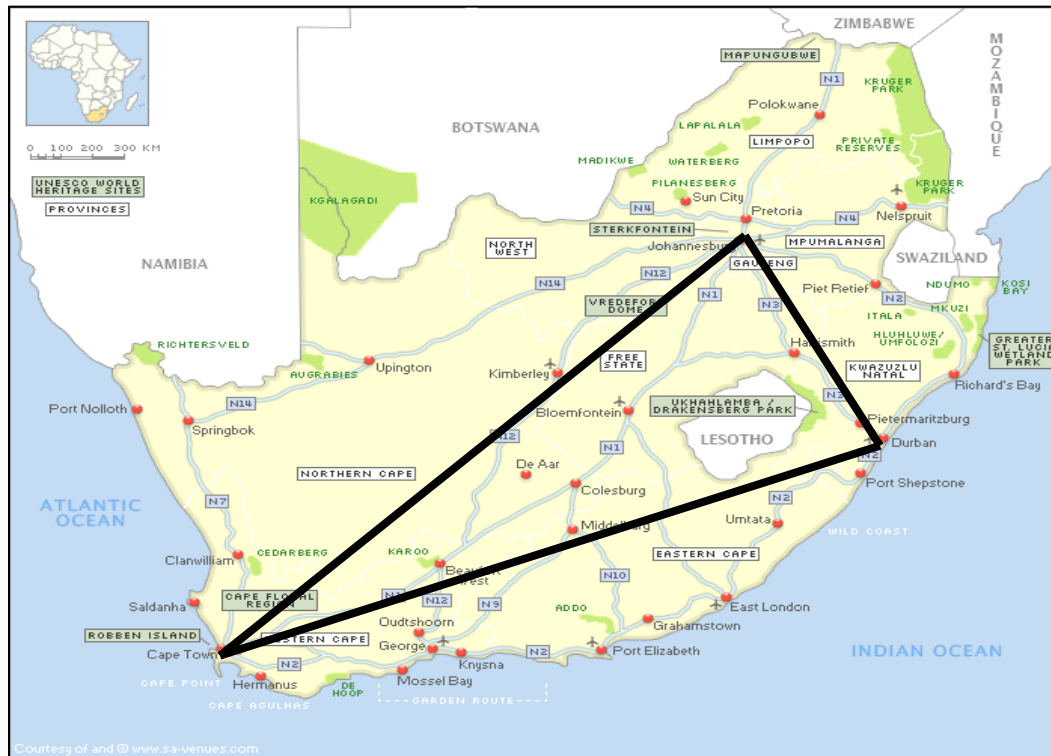
● SAA direct influence ○ SAA indirect influence

Comments

- Strategy centred around JNB hub
- Leverage African network to capture global – Africa traffic flows (which allows growth and economies of scale in JNB hub)
- Capture markets beyond the reach of current SAA network
- Create regional hubs to access secondary markets and feed additional passengers into JNB hub
- Leverage size and fleet strength and management expertise to create a sphere of influence throughout the region

SAA with its alliance partners is the preferred carrier in the domestic market

Domestic market success will be achieved through: Maintaining Johannesburg as a hub and improving connections for Africa and International traffic



Work on a new commercial agreement with SAX and Airlink to cover the domestic market comprehensively.

Develop closer relationship with Mango to maximise capacity utilisation on SAA.

The Alliance strategy supports the network strategy by...

- Profitably growing SAA's direct network reach through non-operated flights and
- Supporting the direct services that SAA operates by providing large amounts of connecting traffic on the services of SAA's alliances partners.

Regional routes



African and Middle Eastern routes

- **West Africa:** TAAG Air
- **SADC:** Malawi, Air Botswana, Air Namibia, Air Zimbabwe and LAM.
- **Central Africa:** Air CEMAC, LAC Airline
- **East Africa:** Ethiopian Airlines
- **Middle East:** Enhancements to our code share with EL AL, Emirates

International routes

STAR



Our focus is on the premium market

- Even though SAA will be seeking to reduce its unit costs through benchmarking with LCCs, it will continue to focus on the **premium market** and the customers' needs

DOMESTIC	AFRICA (REGIONAL)	INTERNATIONAL
<ol style="list-style-type: none"> 1. On-time departures/arrivals 2. Competent Staff 3. Helpfulness & prompt service 4. Appearance of our physical facilities & equipment 5. Caring individualised attention for passengers 	<ol style="list-style-type: none"> 1. On-time departures/arrivals 2. Competent staff 3. Appearance of our physical facilities & equipment 4. Helpfulness & prompt service 5. Caring individualised service 	<ol style="list-style-type: none"> 1. On-time departures/arrivals 2. Competent Staff 3. Helpfulness & prompt service 4. Appearance of our physical facilities & equipment 5. Caring individualised attention

- The majority of customers are business travel passengers and high yield leisure passengers
- Capacity planning at a group level will increase to obtain maximum benefit for the group between the two offerings in the domestic market: SAA and Mango
- Lounge upgrades and expansion will be in alignment with the cost and premium passenger principles

Global Sales and Marketing

“Most preferred airline”

“Proud to fly with”

**Enhance / Build
Brand Equity**

**Grow market
share**

**Build
sustainable
loyalty**

- Understand Key markets and competition with high traffic volumes
- Define customer needs and requirements in selected segments
- Develop appropriate products (in-flight services)
- Design distribution channels (travel agencies and direct sales)

- Communicate the value proposition
- Build advocate relationships
- Advertise and promote products
- Manage frequent flyer programs

- Customer relations
- Customer Value enhancement
- Monitor customer experience

Commercial

- Revenue Management
 - Responsible for price setting on all routes
 - Determine price according to market demands
 - Determine restrictions applicable to certain fare categories
 - Maintain all information on Global Distribution Systems
 - Maximising revenue
 - Determine fare levels saleable at any point in the cycle of the flight
 - Determine and control overbooking profiles from historic trends
 - Overall responsibility to maximise revenue per available aircraft seat

Operations

- Flight Operations (Flight deck and Cabin crew)
 - Flight training
 - Abinitio and recurrent training
 - Line Operations
 - Crewing for all flights
 - Flight Standards
 - Setting and monitoring of flying standards in conjunction with CAA and aircraft manufacturers
 - Flight Technical
 - To ensure that all aircraft meet minimum Technical specifications
 - Operation Control Centre
 - Manage day to day operations, especially disruptions
 - Current fleet
 - 21 x A340
 - 11 x A319
 - 17 x B737-800
 - 4 x B737-200/300 freighter
 - 3 x B747

Operations

- Ground Operations
 - Overall responsibility of all airport operations
 - Check-in
 - Ground handling by vendors
 - Reservations / ticketing at airports
 - Baggage handling
 - Aviation security
 - To comply with all security regulations for entry into destination countries

Initiatives focusing on Africa

- Raise Standards of African Airports and On-Board Service to International Standards – Lounges, Check-in functionality, Foreign languages on-board
- Performance Based Navigation Project
- African Aviation Training Initiative

And Improving Service Levels

- Implement Service Recovery Team at Airports (SWAT)
- Denied Boarding Compensation (DBC)
- Expand current VIP service to top 100 business people

SAA Technical

- Largest maintenance facility on African continent
 - Occupies 65 ha
 - Hangar space 84 550 m²
 - Workshops 71 058 m²
 - Hardstand 189 030 m²
- Capabilities
 - Line to D check capability for
 - B737 series
 - B747 series
 - B767
 - A320 series
 - Freighter conversion B737-300
- Technical dispatch reliability in excess of 98%
- Staff complement 2700
- Key Challenges:
 - Antiquated systems
 - Shortage of manpower (training programme)
 - Restricted in growth due to financial constraints
- Key opportunities
 - To become preferred MRO for sub-Saharan Africa

SAA Cargo

- An industry to industry business against a consumer based passenger business
- Generates revenue of R2,4-billion per annum from outside sources
- Contributes R1,2-billion to the bottom line of the airline (excluding belly space charges)
- Capitalise on passenger unusable belly space to maximise flight load
- Use dedicated cargo planes to niche markets (e.g. Starlight and Charter operations) and to expand reach (e.g. connectivity to Africa)
- Born out of mailing need, mainly to enable intercontinental communication
- Developed over years in line with world trade and now focus on rapid freight requirements
- Commands a totally different client base to that of PAX
- Integrated to the airline flight operations strategy to ensure compliance with AVSEC promulgations

Key People focus areas

- Ensure uniform standard in managing people by implementing **People Management Standards**
- Build capacity to have sustained operations through a fully integrated **Talent Management** Philosophy, Strategy, System and Intelligence i.e. Succession and Career Planning
- Sustain sound employee relationship by **Continuous Employee and Labour engagement**
- Focus on Labour and other associated costs by means of an Operationalised **Workforce Plan** and People cost measures
- Implement an **Employee Value Proposition** Philosophy and Strategy i.e. top 20% performers can select flexible conditions & work-life balance options
- Inculcate a **Performance Management** culture through enforcement of Performance Management discipline and assist management with tools to management performance of non-management staff.

Support Services

SAA has a number of key support services, including:

- Finance – financial and revenue accounting services; information technology services
- Legal
- Risk
- Business improvement
- Human resources

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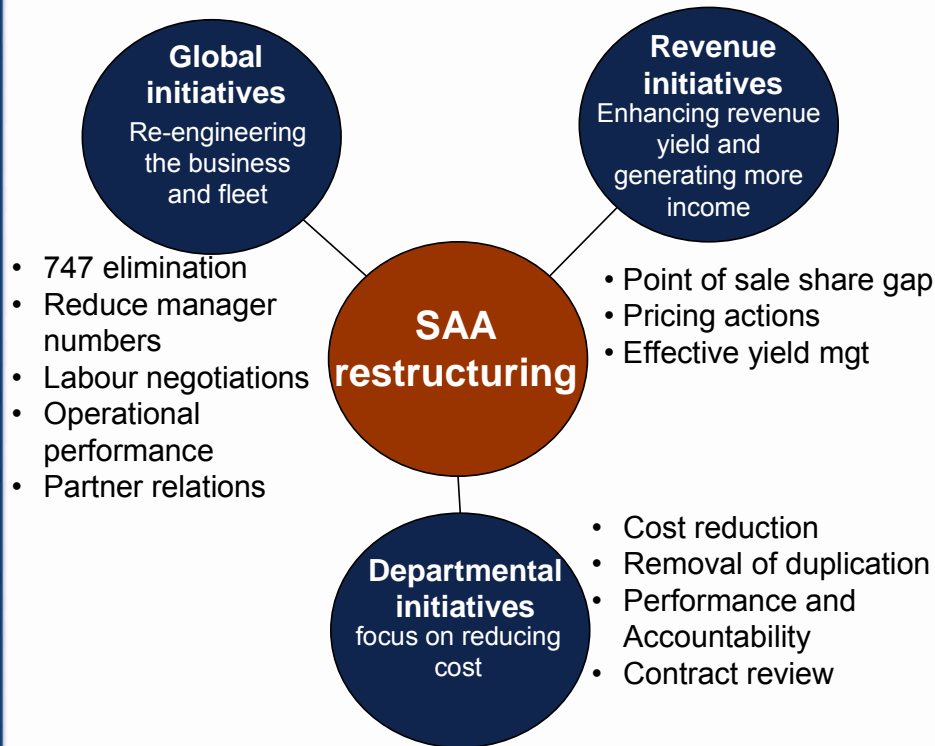
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3. Current and Future Challenges

SAA's Sustainability through restructuring

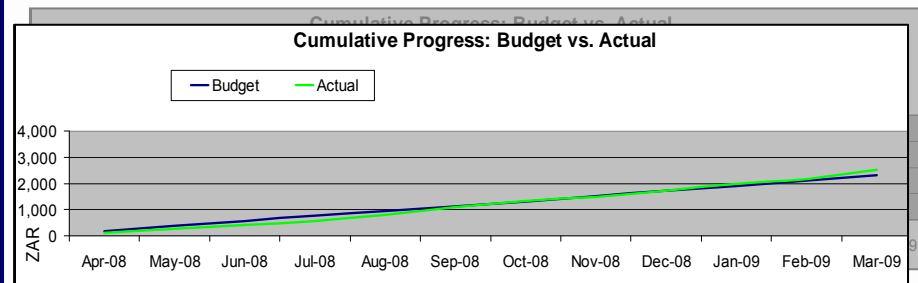
In 2007 SAA embarked on a restructuring programme to ensure sustainability

The Programme



The Results

R2.5b sustainable benefits were delivered against a target of R2.3b – 8% above target



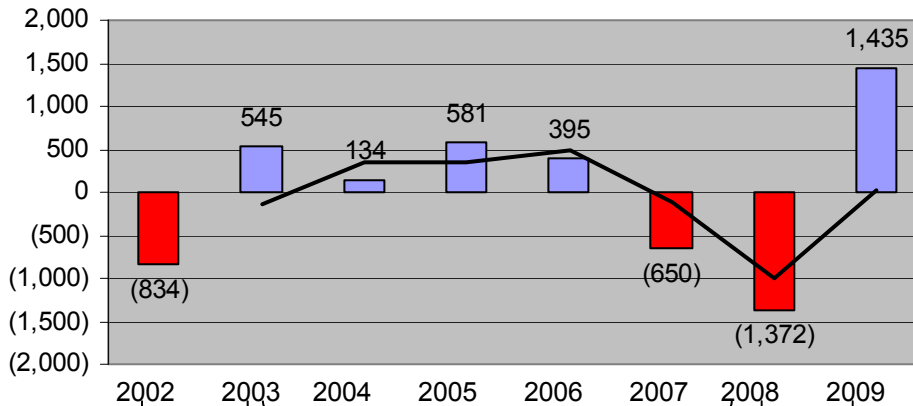
- ✓ Over the period R3.2b benefits were obtained which included once-off “clean-out” activities
- ✓ The restructuring delivered a return of 36% on the sustainable benefits over the 18 month restructuring

SAA's Sustainability through restructuring

The restructuring programme has assisted to place SAA on a sound operational footing to sustainability as seen through the recent results

Year end results

Operating Profit(Loss)



9/11 impact

Excluding Hedging losses

Impact of weak balance sheet, interest rates payments – can not take advantage of upturn in aviation industry

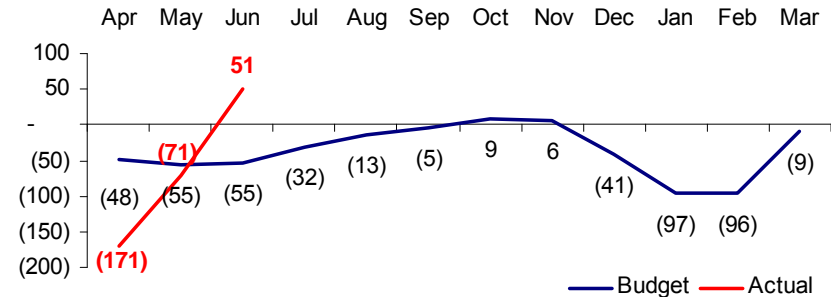
Including restructuring costs

Despite economic downturn. Excluding hedging losses

1st Q results

Despite the economic downturn SAA has performed almost R100m better than original budget for the 1st Q

YTD Net profit/ (loss): Month on month tracking



Weathering the storm. Maintaining Growth

- SAA was fortunate to start the restructuring in a buoyant market
- **As a result, SAA is operationally profitable**
- We will weather the storm by **continued strict cost containment culture**, efficiency improvements, strategic and effective procurement, focus on proactive revenue management, capacity redeployment, improved channels of distribution and targeted sales efforts
- We must prepare for the inevitable growth after this downturn through decision making on our fleet, network expansion through partnerships and retention of and investment in our people
- Africa will remain SAA's key operational focus for expansion
- While cost control is paramount, Safety stays non-negotiable
- SAA will continue to contribute to the larger governmental goals and GDP growth through the support of tourism and trade airlift

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Recapitalisation: Traditional weak balance sheet

Background

2003 currency losses of R14,6-billion

2006: Transnet inject R8,5 billion in **equity**

2007: Government give R1.3b **guarantee** for going concern issue

2008: Government give R653m for VSP restructuring

2008: Government give R1.56b **guarantee** for grounding of B747 restructuring

2009: Government give R1.5b to be used to settle the subordinated loan of R1,5bn

Impact

Wiped out the share capital of SAA

Undercapitalised by Transnet.

Borrow from financial institutions – high interest cost & Pressure on working capital and profitability

Accounting Statements required classification as equity. The 2008/9 operating results were impacted by R165m costs which could not be offset against funding..

Borrow from financial institutions – additional R200m interest .SAA has a higher debt to turnover ratio than most other airlines around the world

Lack of capitalisation continues to pose significant challenges for SAA

Air Traffic Liability

Background and impact

- In terms of both the International and Domestic Air Services Act, all SA carriers are obliged to have a guarantee in place in order to cover the passengers, who have purchased tickets, but have not yet travelled, against the collapse of the airline.
 - Historically this guarantee was supplied by Transnet and was transferred to DPE at separation in March 08.
 - The current guarantee of R1.6bn provided by the government expired on 31 March 2009.
 - The DPE has supplied a letter of undertaking for the value of R2.2bn which has been evaluated by the Council and SAA have been advised in writing that the Councils have accepted this.
- The Council has reserved its rights to review the adequacy of this undertaking at any time and it may be reviewed on the issuance of SAA Audited Financial Statement later this year.
 - If SAA is unable to secure a long term solution within the next 12 months, SAA will again be at risk that the Air Service Council may not renew its operating license with effect from 1 April 2010 and new routes will not be approved from that date on.

Airbus

2001/2002: SAA announced a fleet acquisition strategy with the main aim being to replace its ageing fleet of long haul aircraft. Board resolved that SAA purchase 15 A320-200 aircraft. The aircraft order was placed during May 2002 with the first aircraft delivery scheduled to occur in the first half of 2010.

2004/2005: SAA in dire financial situation. Board decided to cancel the A320 purchase agreement. Airbus acknowledged receipt of the cancellation notification but did not confirm acceptance in writing. SAA fully impaired the PDP payments (\$42.8m), which were held as assets on the SAA balance sheet at the end of the 2004. From the 2004/05 financial year, the directors, management, shareholder and auditors dealt with SAA's annual financial statements on the basis that the order had been cancelled.

2007/2008: Airbus informing SAA that the second PDP was due in April 2007 as it held the agreement is not cancelled. SAA met Airbus and reiterated its position that it had cancelled the agreement. SAA had reassessed its accounting treatment of the A320 matter in prior years and concluded that the prior year accounting was correct.

2008/2009: Airbus still of the view that the order remains in force and cannot be cancelled but stated that it would defer the second PDP payment on the first 4 A320 aircraft, on the basis that the parties could reach an agreement on a revised delivery schedule with the aim of moving the deliveries from 2010 to 2011. Negotiations between SAA management, the DPE and Airbus took place where various options were considered regarding on how best to proceed, and some progress was made. A final decision on the way forward is currently being finalised.

Anti-trust Litigation

- **EU:** The EU Competition Commission included SAA in a Statement of Objection (SO) it issued against various air cargo carriers, globally. The SO alleges cartel activities in the air cargo services market. SAA will appeal to the Court of First Instance (CFI) if the EU Commission finds against SAA. SAA's prospects of success on appeal are strong. *SAA's legal team does not assess the prospect of the Commission issuing a fine against SAA to be more than 50%.*
- **Swiss and Australia:** SAA has not received any communication from the relevant authorities, so we assume that the Swiss and Australian Competition Authorities are waiting to consider the outcome of the EU investigation.
- **US:** SAA awaits the decision of the Judge in a motion filed by SAA and other defendants in the class action to dismiss the plaintiffs' law suit.

Market and Customer Challenges

Increased pressure from Consumer & Customer complexity

- Increased customer demands and expectations for service delivery
- Price sensitivity and demand for value
- A customer with more choice

• Increased Competitive pressure

- Low-cost airlines are at a particular advantage in time of a recession
- Increased activity
- They commoditize the category
- They encourage category reappraisal and reassessment of the value of more premium providers
- Mega Airlines and global leaders are focusing on delivering added value and experience

• Increased pressure on Brand SAA

- Brand ambassadorial role puts SAA under pressure
 - When ACSA underperforms SAA faces a negative halo
 - When South Africa has negative PR it affects SAA

Summary SAA's value proposition

- SAA has illustrated over the last 75 years its ability to survive and maintain the fundamentals of an international carrier, which include
 - Well maintained and modern fleet
 - Continued focus on safety, through world class technicians, crew and pilots
 - A well established South African, African and International network
 - Compliance to international and regulatory aviation requirements
 - Operational effectiveness in maintaining a complicated schedule
 - Well established brand recognition – 7th consecutive year – best airline to Africa, 11th for business class and 14th for economy out of 167 airlines
- An unmatched network in Africa, that is launched through a strong position in South Africa and accessed through international networks, all of which is served by a competitive product and high safety standards
- Sound operational model to build on after the restructuring as seen in the operating profit of R1.4b end March 2009 and net profit for the end of 1st Quarter 2009

Thank you