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DEPARTMENT OF COMMUNICATIONS

PRESENTATION TO THE PORTFOLIO COMMITTEE ON COMMUNICATIONS 16 AUGUST 2011

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BACKGROUND



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- In 2008, the SABC was engulfed in a Governance crisis that was triggered by the fractious relationship between the Board and the Group Executive
- The crisis was characterised by a fractious relationship between the Board and the Group Executive Committee
- In July 2009 the Board of the SABC was dissolved.
- The Governance crisis period coincided with the 2008/9 Global Economic and Financial crisis that engulfed the entire global economic system
- For the 2008/09 financial year, the SABC reported posted a deficit of R910 million.
- The SABC blamed Global Economic and Financial Crisis for losses
- Subsequent investigations pointed towards poor Governance as a serious contributor to financial performance of the SABC.
- A Task Team appointed by the Minister of Communications established that the SABC problems went beyond revenues not materialising - crisis was a result of gross financial mismanagement, escalating operational costs, substantial discounts offered to customers and contracts that were unfavourable to the SABC for the purchase of content.

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2

BACKGROUND (Cont.)



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In July 2009, National Assembly introduced amendments to the Broadcasting Act of 1999 to facilitate the resolution of the Governance impasse

Board members began to resign one by one until all of them resigned and the Interim Board was appointed for a period of six months

The Interim Board approach the Government for financial assistance especially to enable the SABC to honour its debts as they become due for payment.

Government agreed to provide the SABC with a cash allocation of R200 million from the 2009/10 Adjustment Estimates budget.

In addition thereto, a Government Guarantee of R1,473 billion was granted to allow the SABC to borrow money from the financial markets.

CONDITIONS OF GOVERNMENT GUARANTEE



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Explicit Revenue enhancement measures include the following:

- **Achieving revenue potential from advertising** – The appointment of Senior Marketing and Sales Director(s), plus the support team to dovetail with advertisers, along with linking Content to advertising potential (Estimated revenue of R535 million)

- **Sponsorships revenue enhancement** of R128 million.
Stabilizing programming schedules and up-skilling the Sales and Marketing Division (estimated at R42 million)

- **Reviewing the Sports Strategy** and considering in interim, a freeze on all local and international Sport Rights except for sport which the SABC is obliged to broadcast

- **Reviewing and implementing Corporate Governance and Procurement policies and procedures** so as to curb fruitless and wasteful expenditure

CONDITIONS OF GOVERNMENT GUARANTEE



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Explicit cost-cutting measures

- **Content Restructuring** – The introduction of commerciality, a broader consensus on selection, arranging advertising at the time of procurement, avoiding content with big net losses, etc (estimated savings of R336 million)
- **Right-sizing the organisation** – The payroll to be reduced through retrenchments and early retirement (estimated saving with of R287 million)
- **Reviewing the professional fees**, especially SAP consulting fees (estimated savings of R136 million)
- **Other cost**, estimated to R72 million were planned to be cut down. The management of the SABC to decide on where to cut these costs.

CONDITIONS OF GOVERNMENT GUARANTEE



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Accountability enforcement and performance monitoring

- The SABC to develop, in conjunction with the Department of Communications, a project plan with completion milestones, timelines and executive responsible for the achievement of each of the identified cost saving and revenue enhancement initiatives
- The plan to form a basis for monitoring on a monthly basis of the cost saving and revenue enhancement initiatives
- Project plan to outline the milestones, timelines and responsibilities for implementing the corrective action to be taken to address issues identified in various reports that include the Auditor-General and the Ministerial Task Team reports etc.

The commitments made by the SABC to be captured in the shareholder's compact to be signed between the Minister of Communications and the Chairperson of the Interim Board of the SABC

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Monitoring Task Team

A team comprising of the SABC, DoC and the National Treasury to be constituted to receive and consider monthly performance progress reports to be produced by the SABC

Monitoring Task Team to make recommendations to the Minister and inform the Minister of Finance as part of performance monitoring

CONDITIONS OF GOVERNMENT GUARANTEE



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A team comprising of the SABC, DoC and the National Treasury to be constituted to receive and consider monthly performance progress reports to be produced by the SABC

Monitoring Task Team to make recommendations to the Minister and inform the Minister of Finance as part of performance monitoring

GOVERNMENT GUARANTEE TARGETS

The Government Guarantee submission included the three scenarios indicated in the tables below

The SABC chose the Base Case Scenario as a basis for applying for the Government Guarantee

CURRENT SCENARIO



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YEAR ENDING MARCH	2009	2010 Budget	2011	2012	2013
REVENUE/INCOME	4,825	5,000	5,304	5,617	5,843
Advertising	3,112	3,367	3,323	3,222	3,733
License Fees	665	672	910	922	944
Sponsorship	416	412	543	579	610
Government	137	149	208	161	196
Content	62	73	84	89	94
Trade Exchange	0	0	99	131	111
Other	232	199	137	475	155
COST OF CONTENT	1,632	2,000	2,004	2,178	2,282
GROSS PROFIT	3,193	3,000	3,300	3,439	3,561
Signal Distribution	440	440	495	522	552
Broadcast Costs	291	291	309	318	344
DISTRIBUTION	2,461	2,461	2,628	2,795	2,795
OVERHEADS	3,418	3,418	3,018	3,439	3,439
People	1,864	1,864	1,819	1,805	1,805
Pension / Med Surplus			0	0	0
Professional Fees	307	307	181	172	164
Marketing	258	258	192	208	214
License Fees	176	176	164	208	216
Depreciation	150	150	316	311	406
Other	654	654	516	491	574
EBIT	-956	-1,000	-522	-516	-774
Net Finance	-65	-65	-167	-168	-168
PBT	-1,022	-1,065	-719	-684	-942
Operating Cash Flow	-662	-500	-581	-177	-851
Reduction in Debt Days			17		19
Capital Expenditure	-343	-343	-500	-500	-500
Funding needs Year	1,005	1,005	1,164	1,062	1,432
Funding Needs Cum	1,005	1,005	2,706	3,068	5,200

9

BASE CASE SCENARIO



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YEAR ENDING MARCH	2009	2010 Budget	2011	2012	2013
REVENUE/INCOME	4,825	5,000	5,609	5,695	6,552
Advertising	3,112	3,313	3,601	3,476	3,733
License Fees	665	672	933	959	944
Sponsorship	416	412	607	704	610
Government	137	149	208	169	196
Content	62	73	84	89	94
Trade Exchange	0	0	99	130	111
Other	232	199	137	475	155
COST OF CONTENT	1,632	2,000	2,004	2,088	2,282
GROSS PROFIT	3,193	3,000	3,565	3,607	3,561
Signal Distribution	440	440	495	522	552
Broadcast Costs	291	291	309	318	344
DISTRIBUTION	2,461	2,461	2,761	2,744	2,795
OVERHEADS	3,418	3,418	2,813	2,770	3,439
People	1,864	1,864	1,476	1,423	1,805
Pension / Med Surplus			0	0	0
Professional Fees	307	307	113	109	28
Marketing	258	258	234	245	256
License Fees	176	176	164	208	216
Depreciation	150	150	316	311	406
Other	654	654	490	471	502
EBIT	-956	-1,000	-52	-464	724
Net Finance	-65	-65	-176	-28	-168
PBT	-1,022	-1,065	-228	-492	-551
Operating Cash Flow	-662	-500	-481	-177	1,778
Reduction in Debt Days			8		9
Capital Expenditure	-343	-343	-400	-400	-400
Funding needs Year	1,005	1,005	482	1,062	-534
Funding Needs Cum	1,005	1,005	2,165	3,227	1,258

10

PROBABLE CASE SCENARIO



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YEAR ENDING MARCH	2009	2010 Budget	2011	2012	2013	2014
REVENUE/INCOME	4,825	4,890	5,745	6,260	6,552	6,883
Advertising	3,112	3,159	3,501	4,047	4,288	4,492
License Fees	565	572	956	968	890	894
Sponsorship	416	512	671	704	728	772
Government	137	154	208	181	196	201
Content	62	78	84	89	94	100
Trade Exchange	0	89	99	106	111	117
Other	232	190	137	147	155	164
COST OF CONTENT	1,832	1,590	1,892	1,572	1,946	1,598
GROSS PROFIT	3,183	3,400	3,565	4,388	4,606	5,285
Signal Distribution	440	467	495	439	552	583
Broadcast Costs	291	293	309	328	344	364
DISTRIBUTION	2,461	2,510	2,781	3,223	2,795	2,947
OVERHEADS	2,461	2,450	3,049	3,459	3,710	3,840
People	1,864	1,751	1,332	1,022	1,515	1,918
Pension / Med Surplus			0	0	0	0
Professional Fees	307	171	45	36	28	18
Marketing	258	183	234	243	258	268
License Fees	176	183	194	205	216	228
Depreciation	159	73	316	341	466	441
Other	664	453	444	172	502	533
EBIT	-956	152	484	898	724	630
Net Finance	-60	139	-162	-154	-83	-111
PBT	-1,022	291	322	744	641	519
Operating Cash Flow	-662	290	-581	-171	-651	-
Reduction in Debt Days		290	17	19	19	20
Capital Expenditure	-343	-500	-400	-400	-400	-400
Funding needs Year	1,005	210	-77	-171	-640	-640
Funding Needs Cum	1,005	1,005	1,465	1,465	138	138

11

Turnaround Plan and SizweNtsaluba Report



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- ① The SABC was requested to develop a turnaround plan to stabilise, reposition and place corporation on sustainable financial position going into the future.
- ① With the support of Deloitte and Touche, the SABC developed and secured approval by the Board in November 2010, a high level turnaround plan
- ① The Turnaround Strategy identifies six key thematic areas through which the SABC will be turned around:
 - Leadership and governance;
 - Financial Management and Controls;
 - Reorganisation and people alignment;
 - Human Capital Development;
 - Improve return on programming operations; and
 - Restoring credibility and brand.

12

Turnaround Plan and SizweNtsaluba Report *cont...*



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- ① The SABC has identified approximately one hundred and eight projects that need to be implemented to achieve objectives of its turnaround plan.
- ① A turnaround project steering committee that consists of all Group Executive Committee members, meets fortnightly to monitor project implementation
- ① Project charters and project plans were drafted and signed off by Group Executive.
- ① Turnaround project resource requirement reviewed and budget requests were made and the project management office and governance structure were set up.
- ① After disagreement on the financial projections, Sizwe Ntsaluba vsp was appointed to review and give an independent opinion on the credibility of the projections and the underlying assumptions provided by the SABC



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13

Turnaround Plan and SizweNtsaluba Report *cont...*



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- ① SizweNtsaluba report concluded that, "differences in GG Targets and the projections are not ideal as it shows that there are inefficiencies when it comes to the implementation to achieve the targets set, a consistent process needs to identify where GG are matched to the projections.
- ① The report concluded that, based on the review of the provided targets and the forecast, and given the history of the SABC meeting its budget, it does not appear that the SABC would be able to meet the GG targets set out."



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14

Implementation of Agency measures and revenue enhancement



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Cost Cutting Measures:

- ① Reduction in headcount from February 2009 to June 2011 (net reduction in the region of 400) due to stringent governance processes
- ① Re-appointment of staff; as well as natural attrition and contracts not renewed for positions no longer required
- ① Voluntary separation options such as voluntary early retirement, voluntary severance, etc first before any drastic measures are taken
- ① Combined effect of cost cutting initiatives resulted to a further reduction of R104 million of operational costs during the year ended 31 March 2011
- ① Employee compensation and benefits reduced from R1.753 billion in 2010 to R1.705 billion in 2011(as per audited financial statements)

Implementation of Agency measures and revenue enhancement



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Revenue Enhancement:

- ① Trading and Pricing Model, which, if approved, would be implemented in F2012/13 only
- ① R115m additional revenues from outsourcing Sponsorship Revenues
- ① TV Licence Moratorium - this initiative was put on hold and ASD is awaiting further guidance;
- ① TV Licence Tariff Increase – subject to Board approval
- ① Government Subsidy in respect of Concessionary TV Licence Holders – subject to Board approval
- ① Government Subsidy in respect of lower LSM Households – subject to Board approval;
- ① The combined effect will result in an increase in the revenue totalling at least R800 million (as per budgeted figures) for the financial year ending 31 March 2012



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FINANCIAL INFORMATION

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17

Revenue and Expenditure



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- ① The SABC derives its revenues from Advertising; Sponsorship; Trade Exchanges; licence Fees; Government Grants; Content & Commercial Exploitation; Revenue Websites and Other Revenues.
- ① The main contributing revenues include Advertising (70%), Licence Fees (16%) and Sponsorship (9%).
- ① The bulk of SABC's expenditure include employee compensation and benefit (32%); amortisation of programme, film and sport rights (31%); signal distribution and linking cost (9%) and Broadcast cost (6%).

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2010/11 Financial Performance



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- ① The total revenue for the year amounted to R5.293 billion, almost on par with the respect budget of R5.306 billion
- ① The better performance due mainly due to the 2010 FIFA World
- ① The total revenue fallen short by R275.558 million as compared to the Government Guarantee targets
- ① **Advertising revenue (R3.5 billion)** exceeded the budget of R3.3 billion by 5% mainly driven by the 2010 FIFA World Cup.
- ① In respect of the Government Guarantee, the actual advertising revenue has exceeded by just a small margin
- ① **Sponsorship:** sponsorship revenue amounted to R484 million, lower than the budget of R669 million by 28% due to under performance in sponsorship revenue
- ① In respect of the Government Guarantee, sponsorship revenue has fallen short by R123 million

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19

2010/11 Financial Performance (Cont...)



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- ① **Licence Fees** amounted to R872 million and was lower than the budget by 2%.
- ① TV Licence revenue targets not met due to a delay in the finalisation of the Debt Collection tenders.
- ① There were fewer debt collection agencies on board during the 3rd and 4th quarter and less revenue was collected.
- ① Licence fees have fallen short of Government Guarantee target by about R61 million.
- ① **Total Expenditure:** The total expenditure recorded amounted to R5.328 billion, almost on par with the budget of R5.308 billion.
- ① Total expenditure was better than the Government Guarantee target of R5.583 billion

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20

2010/11 Financial Performance (Cont...)



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- ① **Employee Compensation & benefits:** performed above budget, R1.705 billion versus R1.618 billion.
- ① The line item is headcount related and constitutes 30% of the total expenses and was up from 23% in 2007.
- ① There has been a decline in the headcount of the SABC from 4125 in February 2009 to 3677 in June 2011.
- ① Employee Compensation has fallen short of Government Guarantee by R229 million
- ① **Amortisation & Impairment of Program, Film & Sports Rights** were R1.677 billion against the budget of R1.669 billion. In respect of the Government Guarantee, the actual costs were
- ① **Education programming** performed below budget due to shifts in scheduling due to the Soccer World Cup and cancellation of the Vodacom Challenge.

21

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2010/11 Financial Performance (Cont...)



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- ① **Signal Distr. & Linking:** no major variance between the actual and the budget
- ① **Broadcasting costs:** The variance between the budget and actual is about 5%. The actual and budget costs were R338.173 and R321.139 million respectively

22

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PERFORMANCE AGAINST GOVERNMENT GUARANTEE



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GOVERNMENT GUARANTEE INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH 2012

	SABC		GOVERNMENT GUARANTEE		DIFFERENCE	
	FY10/11	FY11/12 forecast	FY10/11	FY11/12	FY10/11	FY11/12
	R'000	R'000	R'000	R'000	R'000	R'000
Revenue						
Advertising	3,504,715	3,613,472	3,501,000	3,578,000	3,715	(264,528)
Sponsorships	483,937	565,600	607,000	704,000	(123,063)	(138,400)
Trade exchange revenue	64,977	127,796	99,000	104,000	(34,023)	23,796
TV Licences	872,050	909,334	933,000	968,000	(60,950)	(58,666)
Government Grants	145,257	145,485	208,000	191,000	(62,743)	(45,515)
Other	222,506	251,029	221,000	238,000	1,506	(15,029)
Total Revenue	5,283,442	5,612,686	5,569,000	6,081,000	(275,558)	(468,304)
Less: Expenditure	(5,326,315)	(5,484,331)	(5,583,757)	(5,580,455)	255,442	(172,893)
Amortised Prop. Film & Sport rights	(1,597,178)	(1,469,879)	(2,004,000)	(2,008,000)	406,822	538,121
Broadcast costs	(338,173)	(376,256)	(309,000)	(528,000)	(29,173)	(50,256)
Signal Distribution	(495,070)	(550,494)	(495,000)	(523,000)	(70)	(27,494)
Employee Compensation & Benefits	(1,705,338)	(1,627,582)	(1,478,000)	(1,422,000)	(229,338)	(205,582)
Marketing	(108,709)	(230,892)	(234,000)	(245,000)	125,291	14,008
TV Licence Collection cost	(126,877)	(189,275)	(194,000)	(205,000)	67,123	15,725
Professional and Consulting Fees	(167,121)	(158,702)	(113,000)	(36,000)	(54,121)	(122,702)
Other Opex costs	(300,338)	(408,569)	(324,210)	(318,131)	23,872	(90,438)
Other Personnel costs	(47,999)	(42,901)	(86,910)	(85,280)	38,911	42,378
Other Admin costs	-	(64,115)	(31,637)	(31,044)	31,637	(33,071)
Other (profits)/losses	(1,280)	(1,002)	-	-	(1,280)	(1,002)
Other Impairments	(168,024)	-	-	-	(168,024)	-
Employee Benefit re-evaluations	-	(86,169)	-	-	-	(86,169)
Depreciation of PPE	(272,408)	(288,815)	(316,000)	(391,000)	43,592	102,385
Operating profit before interest and tax	(34,873)	118,365	(14,757)	490,545	(20,116)	(286,411)
Less: Net Financing loss	(84,537)	(105,909)	(213,243)	(262,545)	128,706	156,636
Interest Received	42,771	11,744	-	-	42,771	11,744
Interest Paid	(127,308)	(117,653)	(213,243)	(262,545)	85,935	144,892
Profit/ (Loss) before income tax	(119,410)	12,456	(228,000)	228,000	108,590	(138,775)
Income Tax	-	-	-	-	-	-
Current year Income Tax	(9,861)	-	-	-	(9,861)	-
Profit/ (loss) for the year	(129,271)	12,456	(228,000)	228,000	(78,295)	(138,775)

23

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2011/12 1ST Quarter performance of the SABC



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- The total revenue recorded amounted to R1.352 billion and matched the budget for the period
- Advertising revenue** amounted to R955 million and exceeded budget of R905 million by 6%. This is also in excess of the advertising revenue for the prior year of R934 million
- Sponsorship** revenue amounted to R107 million, higher than the budget of R89.4 million by 20%. The recorded sponsorship revenue was lower than the revenue of the same period in the prior year
- Licence Fees:** amounted to R198 million and were lower than the budget as well as that of the prior year's by 10% and 2% respectively

24

2011/12 1ST Quarter performance of the SABC (Cont...)



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- ① The total revenue recorded amounted to R1.352 billion and matched the budget for the period
- ① **Advertising revenue** amounted to R955 million and exceeded budget of R905 million by 6%. This is also in excess of the advertising revenue for the prior year of R934 million
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- ① **Licence Fees:** amounted to R198 million and were lower than the budget as well as that of the prior year's by 10% and 2% respectively

25

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2011/12 1ST Quarter performance of the SABC (Cont.)



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- ① **Total Expenditure** amounted to R1.143 billion and was lower than the budget of R1.391 billion and the expenditure recorded for the same period last year by 18% and 12% respective
- ① **Employee Compensation & benefits** performed lower than budget, R392 million versus R438 million
- ① **Amort. & Imp. Prog, film & Sports Right:** actual recorded was less than the budget and with what was recorded in the previous financial year by 7% and 30% respectively

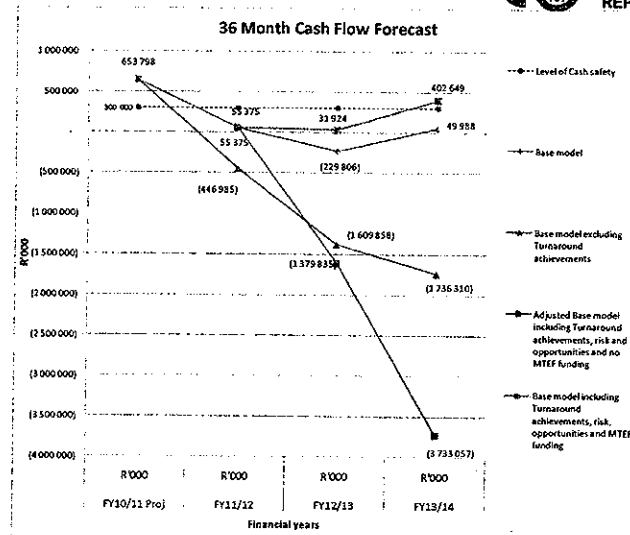
26

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36 MONTHS CASH FLOW PROJECTIONS



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27

36 MONTHS CASH FLOW PROJECTIONS (Cont.)



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- ① The main assumption in all four scenarios is that the SABC will be making significant investment that will largely be driven by the era of digital media
- ① In all four the SABC will have liquidity pressures for the 2012/13 to 2013/14 financial years as the cash will fall below the safety level of R300 million
- ① The first three scenarios (represented by blue, red and grey graphs), the SABC will have negative cash flow from the 2012/13 financial year to the FY 2013/14
- ① Without Government funding, the SABC projects that the cash flow will deteriorate to R3.7 billion at the end of the 36 months even if the turnaround is achieved
- ① The SABC recommends scenario four (green graph) which includes the combination of the turnaround achievement and the Government funding and will achieve cash safety level in the middle of tFY2013/14

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28

CONCLUSION



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- ① The evidence presented above suggests that the SABC is on the right track in terms of meeting the conditions of the Government Guarantee
- ① A line item by line item comparison of the key Income Statement items such as the main categories of revenues and the main cost drivers suggest an improved performance first three scenarios (represented by blue, red and grey graphs),
- ① The SABC will have negative cash flow from the 2012/13 financial year to the FY 2013/14
- ① Without Government funding, the SABC projects that the cash flow will deteriorate to R3.7 billion at the end of the 36 months even if the turnaround is achieved
- ① The recommends scenario four (green graph) which includes the combination of the turnaround achievement and the Government funding and will achieve ash safety level in the middle of tFY2013/14

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29

CONCLUSION (Cont...)



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- ① The major revenue items of the SABC are Advertising, Sponsorships, Trade Exchanges, Television Licences, Government Grants and other
- ① A comparison of these items for the FY 2010/11 against the same line items as reflected in the Government Guarantee reveals that Advertising, and other revenue have exceeded the Government Guarantee targets.\
- ① The remaining revenue line items have performed below the Government Guarantee targets
- ① In its monthly reports to the Monitoring Task Team, the SABC highlighted Sponsorship revenue as the main revenue item that continually presents a challenge to the Corporation
- ① On the overall the total revenues of the SABC lagged the Government Guarantee target by R275 million

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CONCLUSION (Cont...)



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- ① The major cost drivers include Employee Compensation, Amortisation and Impairment of Programmes Film and Sports Rights, Signal Distribution and Linking Costs and the Broadcast costs
- ① A comparison of these items for the FY2010/11 against the Government Guarantee conditions as reflected in the base case scenario that was preferred by the SABC and accepted as a basis of granting the Government Guarantee reveals that only Employee Compensation and Benefits, Broadcast Costs and Professional and Consulting fees have performed worse than the Government Guaranteed targets
- ① All other major expenditures in the year ended 31 March 2011 performed better than the Government Guarantee targets.

CONCLUSION (Cont...)



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- ① On the overall and based on the bottom line, the SABC has performed better for the year ended 31 March 2011 when compared to the Government Guarantee target i.e. a loss of R228 million
- ① The actual performance of the SABC has been a loss of R129 million
- ① An addition of some items that were omitted in the Government Guarantee target increases this bottom line to R214 million which is still slightly better than the Government Guaranteed target
- ① This performance has been achieved mainly by a combination of a slight increase in the advertising revenue and a reduction in the some major costs items
- ① While the SABC may be said to be improving, there remains some challenges that need to be addressed if there is to be a level of comfort with the performance of the SABC

CONCLUSION (Cont...)



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- ① Some of the challenges relate to the performance of the SABC 3 platform which apparently is still posing a difficult to the Corporation
- ① The Corporation also reports that the sponsorship revenues remain a challenge as it is performing erratically
- ① Scheduling instability still affects the sponsorship revenues in a major way
- ① The Marketing and Sales Division is reported to be another major challenge, especially as it relates to the expertise needed to develop programmes needed to drive sales
- ① With respect to implementation of the Turnaround Strategy, it seems the SABC has identified the right interventions needed to bring stability to the organisation
- ① However, going forward the implementation of the turnaround is heavily dependent on funding being provided

CONCLUSION (Cont...)



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- ① This is a major risk to the success of the turnaround strategy as there is always a chance that funds may not be made available
- ① Another area of major concern is the conclusion that was arrived at by the SizweNtsaluba Report
- ① According to this report, "Differences in GG Targets and the projections are not ideal as it shows that there are inefficiencies when it comes to the implementation to achieve the targets set, a consistent process needs to identify where GG are matched to the projections
- ① Based on the current review of the provided targets and the forecast, and given the history of the SABC meeting its budget, it does not appear that the SABC would be able to meet the GG targets set out."



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THANK YOU

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35