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SUMMARY OF THE SOUTH AFRICAN FORESTRY COMPANY LIMITED'S (SAFCOL) ANNUAL REPORT 2010/11

1. Introduction.

The mandate of the South African Forestry Company Limited (Safcol) is determined by the Management of State Forests Act, No. 128 of 1992, and it is to ensure the sustainable management of forests and other assets within the Safcol Group and to enhance the value of the Safcol Group and play a catalytic role in the realisation of the State's afforestation, rural development and economic transformation goals.[1]

Safcol is one of the nine State-owned companies under the auspices of the Department of Public Enterprises. Like all entities listed on schedule 2 in the Public Finance Management Act (Act No. 1 of 1999) the company has maximum autonomy over its financial activities including day-to-day business activities.[2] Parliament has the responsibility to oversee how state owned companies like Safcol align themselves with government policies and regulations. This includes how they respond to the country's economic challenges and position themselves for the state's developmental agenda.[3]

The Chief Financial Officer's Report states that the focus for the year has been on restoring the Group's profitability, as well as on the close monitoring of the liquidity and gearing levels. This has resulted in the continuous assessment of the capital expenditure to ensure that the credit facility is utilised and the cash resources preserved as far as possible. The efforts implemented have resulted in an improvement in the loss before taxation of R486 million compared with the previous financial year.[4]

2. Safcol's vision

Safcol's vision is to be a world class, global business engaged in multi-functional forestry, revolutionalising the integration of forests and communities.[5]

3. Safcol's Mission.[6]

Safcol's mission is driven by an unwavering commitment to facilitate sustainable economic empowerment of communities and eradication of poverty through:[7]

[1] Safcol (2010) Annual Report. p.1.

[2] Public Finance Management Act (No 1 of 1999).

[3] Boskati, E (2010).

[4] Safcol (2011) Annual Report. p.16.

[5] Safcol (2009) Annual Report.

[6] Safcol (2006) Annual Report.

- Implementing needs-driven interventions; and
- Becoming a partner of choice for land claimants.

The company is dedicated to growing its business in the forestry value chain and maximising stakeholder value through:

- Ensuring technical and business excellence by attracting and retaining the best people;
- Enhancing the asset value by continuously pursuing innovative solutions;
- Embracing and leading an all inclusive equitable transformation of the South African forestry sector;
- Commitment to meaningful partnerships with stakeholders;
- Practising transparent and fair marketing;
- Develop the downstream value chain; and
- Being environmentally responsible.[8]

4. Government's historic strategy[9]

The Minister of Public Enterprises announced during March 2007 that Komatiland Forests (KLF) should be disposed of as a going concern by early 2009. It was also envisaged that Safcol would be wound up by 31 March 2009. In his announcement, the Minister indicated that the Safcol Board of Directors would be responsible for overseeing the process and should advise Government on the structure of the transaction within the transaction guidelines and principles laid down by his Department.[10]

Guidelines developed by the Department of Public Enterprises, setting out the goals and objectives for the privatisation of KLF and the winding up of Safcol were received during August 2007. Safcol appointed legal and transaction advisors to perform a thorough due diligence and to develop a preferred transaction design for consideration by the Board and submission to the Minister, the sole Safcol shareholder on behalf of the State. [11]

After submission of the first draft transaction design to the Minister which highlighted the need for an increasing role of communities, it was clear that certain key issues which could have a major impact on the privatisation of KLF should be addressed before decisions could be made on the way forward. [12]

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[7] Safcol (2009) Annual Report.

[8] Safcol (2011) Annual Report.

[9] Boskati, E. (2010).

[10] Department of Public Enterprises, (2012).

[11] Ibid.

[12] Ibid.

The future outlook for Safcol encompasses the design of a transaction that will ensure its continued contribution to the sector in terms of:

- Addressing structure and regional dominance issues;
- Efficient market operation which will ensure equal access for all market particulars to the raw material;
- Maintaining sustainable management of the forests and other assets until transfer is complete;
- Preparing KLF for a smoother transition to the private sector, contribution to the growth and development of the second economy; and
- Preparing Safcol for eventual winding down.

Safcol's assets can now be categorised into operating, dormant and those held for sale:

Operating subsidiaries

- Komatiland forests (100 percent)[13]
- IFLOMA (80 percent)[14]
- Mountains to Oceans Forestry (Pty) Ltd (100 percent)
- Kamhlabane Timber (Pty) Ltd (100 percent)
- Temba Timber (Pty) Ltd (100 percent)[15]

Dormant subsidiaries

- Lakenvlei forest lodge (Pty) Ltd
- Abacus forestries (Pty) Ltd
- Mistlands timber (Pty) Ltd

Investments held for sale

- Siyaqhubeka (Pty) Ltd
- Amatole forestry company (Pty) Ltd
- MTO forestry (Pty) Ltd
- Singisi forest products (Pty) Ltd

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[13] According to the SAFCOL Annual Report 2011, SAFCOL owns 100 percent of Komatiland Forests.

[14] Indùstrias Florestais de Manica, SARL, is a public limited liability company, registered in Mozambique. The IFLOMA project was originally established in the 1980's as a government initiative. The plantations were established on an area of approximately 19 000 hectares, providing sawlogs to two sawmills. The operations are located in the Manica district, Manica Province in the centre of the Republic of Mozambique along the Beira corridor - an ideal location from which to serve markets in Mozambique, Zimbabwe and South Africa. See: http://www.safcol.co.za/index.php?option=com_content&view=article&id=41&Itemid=13

[15] Safcol (2011) Annual Report. P.5.

5. Land claim management

Following the instruction to proactively engage in the resolution of land claims, Safcol has since been restructured to specifically focus on the facilitation of the resolution of land claims. The following efforts have been made in an attempt to expedite the resolution of claims:

- Participation in the forestry task team where both Safcol and other commercial forestry claims were given priority;
- Safcol initiated operational-specific meetings where officials from Safcol and Regional Land Claims Commission (RLCC) offices discuss specific claims;
- Various mapping resources have been offered to RLCCs in an effort to fast-track the resolution of the claims;
- Safcol, in conjunction with a team from the Department of Rural Development and Land Reform, drafted a framework for cooperation to be signed by both parties;
- Safcol has continued to engage the relevant role players in developing a preferred settlement model; and
- Through the socio-economic development unit, Safcol has continued to engage the land claimants to clarify issues relating to land claims on Safcol land and to ensure that Safcol is positioned as a preferred partner of choice to successful land claimants.[16]

5.1. Challenges facing land claim management

- In spite of all the efforts and progress in facilitating land claims resolution, progress was very slow in all the three provincial land reform offices. Claimants are starting to build structures on KLF managed land within plantation compartments;
- No agreed settlement model for the settlement of claims on KLF-managed land has been developed or agreed;
- Safcol being the operating entity on State land does not have the delegated mandate on the resolution of the land claims;
- The State land disposal process is slow and complicated;
- Disgruntled land claimants tend to raise their frustration regarding the protracted land claims process by threatening to burn KLF plantations. [17]

6. Financial and commercial sustainability

The Group's new marketing process and the cost containment initiatives that were put in place ensured that the Group's performance improved despite the harsh economic

[16] Safcol (2011) Annual Report. P. 32-33.

[17] Safcol (2011) Annual Report. P. 32-33.

conditions. The Group incurred a loss before taxation excluding the effect of the fair-value adjustments of R69 million compared with a loss of R246 million in the previous year.

The loss to date has been positively influenced by the increase in external sales revenue of R274 million (2010: R425 million decline). Continued cost-saving initiatives implemented in the previous year also contributed positively to the Group's financial position. There were slight contributions to other income due to the dividend received from one of the minorities as well as a penalty income received for the failure to take up the volumes as per the agreement.[18]

The trend for revenue over the past five years has been upward, except for the 2010 financial year. There was an improvement in the revenue performance during the current financial year as compared to the last 5 years yearly average of R696 million. The current financial year's recovery was mainly due to increases in volumes sold. The volumes sold during the financial year is 1 154 927 m^3 of logs which represent a year-on-year increase of 56 percent, while the lumber sold increased by 82 percent (61 495m^3) to 136 096m□ compared with the 2010 financial year.[19]

The operating loss has improved by 71 percent as compared with the R278 million experienced during the 2010 financial year; however, the performance is still lagging behind the yearly average performance of the past five financial years.[20]

7. Safcol's Key Strategic Objectives.

The key strategic goals identified to support the strategic themes that have been included in the Safcol Group's corporate plan for 2011 to 2015 are as follows:

- Position Safcol's operations as an attractive business partner;
- Create economically vibrant forest communities where people desire to live and wish to return to;
- Fully embrace all aspects of the sector's transformation charter and rise above it;
- Build, attract and retain skills;
- Increase financial value by 50 percent (in real terms) to current and future shareholders;
- Practise world-class, sustainable forest management;
- Increase forestry area under management;
- Increase value-added services to customers and B-BBEE participation in the industry;
- Develop solid brands (Safcol, KLF and IFLOMA); and
- Develop and invest in the downstream processing industry.[21]

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[18] Safcol (2011) Annual Report. P. 13.

[19] Safcol (2011) Annual Report. P.16-17.

[20] Safcol (2011) Annual Report. P.16-17.

[21] Safcol (2011) Annual Report. P.1.

The Chief Executive's Report states that the major challenge during the year has been the Group business model which was not flexible enough to adapt to the changing economic circumstances. The land claims, which have not yet been resolved, continue to be a concern and might impose some risks to the operations. The loss of productive land has been experienced and remains a threat going forward. The natural disasters such as rain damage and baboon damage experienced during the year also remain a challenge.[22]

8. Targeted outputs

The Safcol Group was not able to meet some of the targets as set out in the shareholder's compact entered into between the Safcol board and the Department of Public Enterprises (signed 28 September 2010). Some of the areas where targets were not met for 2011 are set out below:

8.1. *Financial and commercial sustainability:*

- EBITDA[23] / Revenue: The target for 2011 was 3 percent and the actual achieved was -4 percent; and
- Return on equity [24](Net profit after tax / equity): the target for 2011 was 10 percent and the actual achieved was -5 percent.
  The Group was not able to meet its financial target due to losses experienced during the period under review as result of lower revenue than anticipated. Although the Group did not meet its target, it has shown an improved performance against prior year.

8.2. *Credit worthiness:* Cash interest cover: target for the year was 2 and actual achieved was -1. Negative cash flow from operations experienced during the current financial year due to the loss after taxation and increase in trade receivables as result of extended payment terms to customers and increased sales. It was anticipated that Safcol would incur positive cash flows from operations that did not materialise.

8.3. *Sustainable forest management* (Area of forest under-management): The key performance indicator is the total gross stocked area, in hectares, including temporarily unplanted areas, and all subsidiaries in which Safcol has a controlling equity stake, but excluding associated companies. The target for 2011 was 140 000 ha and the actual was 139 000 ha. The parties acknowledge that the land

[22] Safcol (2011) Annual Report. p.14.

[23] EBITDA Profit / Loss from operations before depreciation, amortisation, profit on the sale of interest in businesses, impairment of assets, dividend received, post-retirement benefit obligation (cost) / income, fair-value adjustments, income / (loss) from associates and net finance costs.

[24] Equity: average reported total of capital and reserves.

claims and the delineation (in terms of the National Water Act) processes currently under way might affect this in South Africa.

8.4. *Transformation*: the target for 2011 was >1percent of net profit after tax excluding plantation valuation per year (R7 million per year).The target of R7 million was not met due to some infrastructural projects which started close to the financial year end and was thus not completed. These projects are managed according to a project plan and will be completed in the next financial year.

9. Operations

The Group has reported a loss before taxation of R103 million which has improved by 83 percent compared with the R589 million experienced during the 2010 financial period. The Group's improved results have been influenced by the following:

- An improvement of 63 percent on the revenue performance which amounted to R706 million for the year under review. The sales performance has been influenced by a year-on-year increase of 58 percent in sales volumes and higher than expected average lumber selling prices due to the product mix sold. The average selling prices of logs, poles and other were below the 2010 financial year levels.
- The fair-value adjustments on the biological assets were R83 million which represent a decline of 76 percent compared with the 2010 adjustments. The negative impact on the fair-value adjustment was mitigated by a positive adjustment of the fair value of non-current assets held for sale of R48 million and thus contributing positively to the loss.
- The key expenditure drivers for the Group have continued to be employment costs (32 percent); forestry contractors (21 percent); material management (20 percent) and asset management (13 percent). The employment costs for the year amounted to R256 million which represent an increase of 8 percent as compared with the previous financial period; and the current cost include adjustment contribution holiday of R14 million and other surplus adjustment which were aimed at the enhancements of benefits. The forestry contractors spending amounted to R166 million which represents a 4 percent year-on-year increase. Asset management of R99 million increased by 1 percent as compared with the previous financial period. The wet decks were cleared during the financial period upon selling of all timber that was stored due to the fires experienced in 2007 and 2008.
- R6 million was spent on socio-economic development initiatives which constitute 7 percent of the total operating expenditure for the Group. The operating loss improved by 71 percent with a positive net cash flow from operating activities of R5 million compared with the negative cash flow of R104 million for the 2010 financial year.[25]

[25] Safcol (2011) Annual Report. P.18.

10. Financial performance (Summary)

The annual financial statements[26]reflect the financial performance, position and cash flow results of the Group and Company's operations for the year ended 31 March 2011:

- The Group has realised a loss before taxation of R103 million which has improved against a R589 million loss for 2010.
- The results include a negative R83 million fair-value adjustment of the plantation valuation (2010: R343 million decrease).
- The total capital expenditure (CAPEX) for the year under review was R44 million (2010: R69 million).
- The Group managed to save R32 million (2010: R74 million) on the budgeted CAPEX, due to the cost-savings initiatives that were introduced during the period under review.
- The capital commitments at year-end amounted to R11 million (2010: R32 million).[27]

11. Human Resources.

11.1 Safcol's permanent employees

Safcol has a total workforce of *1933 permanent employees* as at 31 March 2011 compared to about 2021 the previous financial year. Employees on *contract are about 52* compared to 99 the previous financial year. About *93 percent of Safcol's permanent staff is black* and black here includes Coloureds and Indians.

In terms of gender equity *women constitute about 20 percent* of Safcol overall staff profile and about 34 percent of these women are at managerial levels. The company has compiled an Employment Equity Plan with alignments to the generic requirements of the Department of Trade and Industry (DTI) and BEE codes contained in the Forestry Transformation Charter. Gender Equity has been one of the major challenges facing the Group.[28]

11.2 Headcount of permanent employees as at March 2011[29]

Employ - Equity	**African**		**Coloured**		**Indian**		**Whites**	
	Female	Male	Female	Male	Female	Male	Female	Male
Top mngmnt	2	3	0	0	0	1	2	4
Senior mngmnt	4	2	1	1	1	0	2	13
Middle mngmnt	5	19	0	2	0	0	8	29
Technical	36	65	6	1	1	0	17	26
Semi-skilled	57	647	7	1	2	1	25	6
Unskilled	212	723	1	0	0	0	0	0
Total	**316**	**1459**	**15**	**5**	**4**	**2**	**55**	**78**

[26] Safcol (2011) Annual Report. P. 58 to 62.

[27] Safcol (2011) Annual Report. P.50.

[28] Safcol Annual Report (2011). P. 25.

[29] Safcol Annual Report (2011) p. 25.

On skills development, Safcol is putting more emphasis on technical and management skills to enhance the skills' capacity of its employees in the forestry sector. The group's training centre called Platorand in Mpumalanga province serves as the centre of learning and excellence and continues to offer learning programmes from technical and soft skills to management and leadership development skills. The company runs a bursary scheme enrolling mostly Safcol's employees on learnership programmes registered with Forest Industries Education and Training Authority (FIETA)[30] and this also include a Management Development Programme for its managers offered by the University of Pretoria.[31]

78 percent of the forest industry workforce is either semi- or unskilled, there are critical shortage of craft or skilled workers, technicians, and professional managers. As the wage system has historically proven to be an efficient and effective means of wealth distribution, it is necessary to skill people incrementally in order to ensure their upward social mobility. The quality of skills ensures a certain quality of life.[32]

FIETA was also instrumental in assisting Safcol to introduce an internship programme. In the year under review, eleven unemployed graduates were placed on twelve-month contract programmes with a view to providing the interns with on-the-job learning opportunities and creating an environment where they could acquire the requisite skills and competences. The ABET programme funded by FIETA started on 14 February 2011. A total of 500 learners are being funded through FIETA programme over a period of 18 months. A total of 496 community members from KwaZulu-Natal, Mpumalanga and Limpopo were assessed and placed according to the Independent Examinations Board ABET Placement Assessment Tool.[33]

12. Auditor's Report.

The financial statements of the South African Forestry Company Limited, which comprise the consolidated and separate statement of financial position as at 31 March 2011, were audited by *PricewaterhouseCoopers Inc,* who stated that:

"In terms of General notice 1111 of 2010, issued in Government Gazette 33872 of 15 December 2010, we considered internal control relevant to our audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. There are no significant deficiencies in internal control that resulted in a qualification of the auditor's opinion on the financial statements and/or findings on predetermined objectives and/or material non-compliance with laws and regulations."[34]

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[30] See: http://www.fieta.org.za/about/default.asp

[31] Boskati, E. (2010).

[32] FIETA, (2012).

[33] Safcol (2011) Annual Report. P. 28.

[34] Safcol (2011) Annual Report. P.42

13. Conclusion.

The Chief Financial Officer has stated that the focus going forward will continue to be cost containment and the achievement of all the targets set within the corporate plan which will ensure that the Group is returned to a financially and commercially sustainable position. The funding strategy will be revisited to ensure that appropriate funding is obtained for significant projects that will be approved by the shareholder during the 2012 financial year. The focus will be to ensure that all the financial obligations of the Group are honoured both on the software, implementation and change management agreements. The preservation of cash, as far as possible, will continue to be a focal point within the Group.[35]

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14. References.

1. Portfolio Committee (2005) Report on State-Owned Enterprises.

2. Public Enterprises (2007) Presentation before the Committee, 13 June.

3. Public Finance Management Act No 1, 1999 (as amended).

4. SAFCOL (2010) Annual Report.

5. SAFCOL (2009) Annual Report.

6. SAFCOL (2006) Annual Report.

7. SAFCOL (2011) Annual Report.

8. Boskati, E. (2010) The South African Forestry Company Limited's (SAGCOL) Annual Report 2010. Parliament. Cape Town.

9. Department of Public Enterprises, (2012). SAFCOL. [Internet] Available at: http://www.dpe.gov.za/state-8_Safcol [Accessed on 24 July 2012].

10. FIETA, (2012) [Internet] Available from: http://www.fieta.org.za/about/default.asp [Accessed on 27 July 2012].

[35] Safcol (2011) Annual Report. P. 19.