19 February 2013

# Portfolio Committee on Public Enterprises

## Annual Report and Financial Statements

# INDEPENDENT AUDITORS REPORT

The Auditors Report consisted of four main reporting areas:

- Audit opinion
- Emphasis of matter paragraphs
- Report on other legal and regulatory requirements
- Internal control

# INDEPENDENT AUDITORS REPORT

## Audit opinion

*"In our opinion, the consolidated and separate annual financial statements present fairly, in all material respects, the consolidated and separate financial position of South African Airways SOC Limited as at 31 March 2012, and its consolidated and separate financial performance and its consolidated and separate cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa and the requirements of the Public Finance Management of South Africa".*

**SAA obtained an unqualified audit opinion for financial year 2011/12 with certain emphasis of matters**

# INDEPENDENT AUDITORS REPORT

## Emphasis of matters (EoM)

The two emphasis of matters were on the following items:

- *Restatement of corresponding figures*
- *Irregular expenditure*

It should be noted that **EoM paragraphs are not audit findings or qualifications**. The auditors were drawing attention to what is already disclosed in the financial statements and Directors' report.

# INDEPENDENT AUDITORS REPORT

## Emphasis of matters

### *1. Restatement of corresponding figures*

*During the year under review there were changes in accounting policies necessitating the restatement of the corresponding figures*

- Land and Buildings
- Maintenance
- Power by the hour (PBTH)
- Voyager revenue

***The cumulative impact of the restatement on the previous year profit result was R3 million***

***Real impact on equity was R2.5 billion***

# INDEPENDENT AUDITORS REPORT

## Emphasis of matters

### *2. Irregular expenditure*

*"Irregular expenditure to the value of R 128 million has been identified and reported in terms of section 40 of the Public Finance Management Act. The reason for the irregular expenditure has been fully disclosed in the director's report."*

*The **total irregular** expenditure of R128 million relates to expenditure incurred **WITHOUT LOSS**.*

- *The expenditure was incurred for the purposes of business continuity and occurred due to non-adherence with the Procure-to Pay supply chain management process – more specifically timeous signing of contract extensions and renegotiations*

# INDEPENDENT AUDITORS REPORT

## Fruitless and wasteful expenditure

- *Fruitless and wasteful expenditure incurred for the year amounted to R4 million – of which R3 million was unavoidable due to baggage claims, penalties and fines costs which are inherent in the aviation industry. The balance of R1 million relates to a specific Virginia State tax penalty due to US supplier oversight*
- *In relation to **avoidable costs** disciplinary and remedial actions have been put in place to mitigate the recurrence of such incidents.*
- *Loss due to **criminal conduct** is estimated at R28 000. Various small amount matters – all dismissed!*

# INDEPENDENT AUDITORS REPORT

## Report on other legal and regulatory requirements

- There were no material findings on the audit of predetermined objectives
- Achievement of planned targets – 52% of total planned targets were achieved
  - 14 Planned targets not achieved – relates to:
  - Profitability and Financial KPI's – 7 *(increases in uncontrollable costs and difficult operating environment)*
  - Improving debt : equity ratio KPI – 1 *(cash and equity position)*
  - Other operational KPI's – 6 *(difficult operating environment)*

## Internal control

No deficiencies in internal control were identified that were considered significant

# AUDIT COMMITTEE REPORT

- The Committee's assessment was that the **overall control environment was effective**
- The Committee was **satisfied with improvements in the internal control environment**
- The Committee was **satisfied with the full implementation of the Critical Financial Reporting Controls project**
- The Committee was satisfied that the annual financial statements were based on appropriate accounting policies and were supported by reasonable and prudent judgments and estimates
- ***However***, the Committee was concerned that SAA is undercapitalised and recognises that a permanent and appropriate capital structure is required for the airline to fulfil its mandate

# ANNUAL FINANCIAL STATEMENTS

- Market outlook provided at SAA's 2011 AGM
- The 2012 Global Aviation Market
- Other achievements
- Financial highlights and results

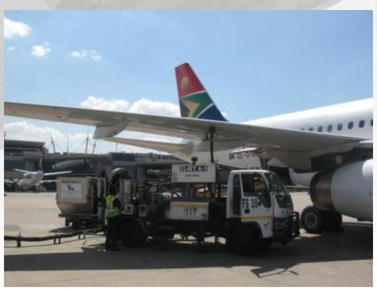
# 2012 Market Outlook Provided at SAA's 2011 AGM

- Low economic growth rates were forecast in several key markets. ✓
- There were early warning signs of a "double dip" recession, which would impact business travel and cargo demand. ✓
- Concern around sustained high fuel prices of above USD110 per barrel. ✓
- Increased capacity, particularly by Middle East carriers, would adversely affect the viability of non-stop operations into South Africa which has a detrimental effect on South African economic growth and job creation. ✓
- New SAA routes would be launched:
  - To Beijing, to strengthen investment and political ties between South Africa, Africa in general and China; and ✓
  - Several new routes would be launched into Africa. ✓

# The 2012 Global Aviation Market

*Volatility in the global aviation market continued throughout the year*

- Low GDP growth rates, in most markets, keeping the demand for passenger and cargo services low.
- Historically low long-term airline industry margins of 2-3% have been forecast by IATA to be 0.6% for 2012.



- Brent crude prices fluctuated, but were consistantly above USD 110 per barrel.
- Jet fuel increased from 28% to 33% of the Group’s operating expenditure year on year.


- Global aviation market consolidation continued to gather pace, particularly in the EU, North America and Asia.
- This concentrated market power and Middle East network carriers are increasingly focused on Africa as one of the few global growth opportunities.

# Other 2012 Achievements, outside our major new routes

- Cost Compression Programme on track to remove in excess of R1 billion in operating expenditure for the 2012-13 financial year.

- June 2012 Oxford Economics study quantifies SAA's annual contribution to South African GDP as R8.6 billion (0.3%) through its catalytic demand effects, as well as:
  - an additional R11 billion in tourism effects;
  - supporting 35,000 (mostly highly skilled) jobs;
  - R1.3 billion in tax and (net) VAT; and
  - R1.1 billion in air passenger charges and other aviation taxes.

- Mango fleet increased from 4 to 6 aircraft and they continue to deliver their mandate of affordable and accessible air travel for lower income South Africans, particularly our previously unflown citizens.

- SAA Flight Academy Project announced, which further strengthen SAA's support of skills development and job growth policy objectives.

- 10$^{th}$ consecutive *Skytrax* award for Best Airline in Africa and 3$^{rd}$ consecutive award for Best Customer Service

# Financial Highlights - 2012

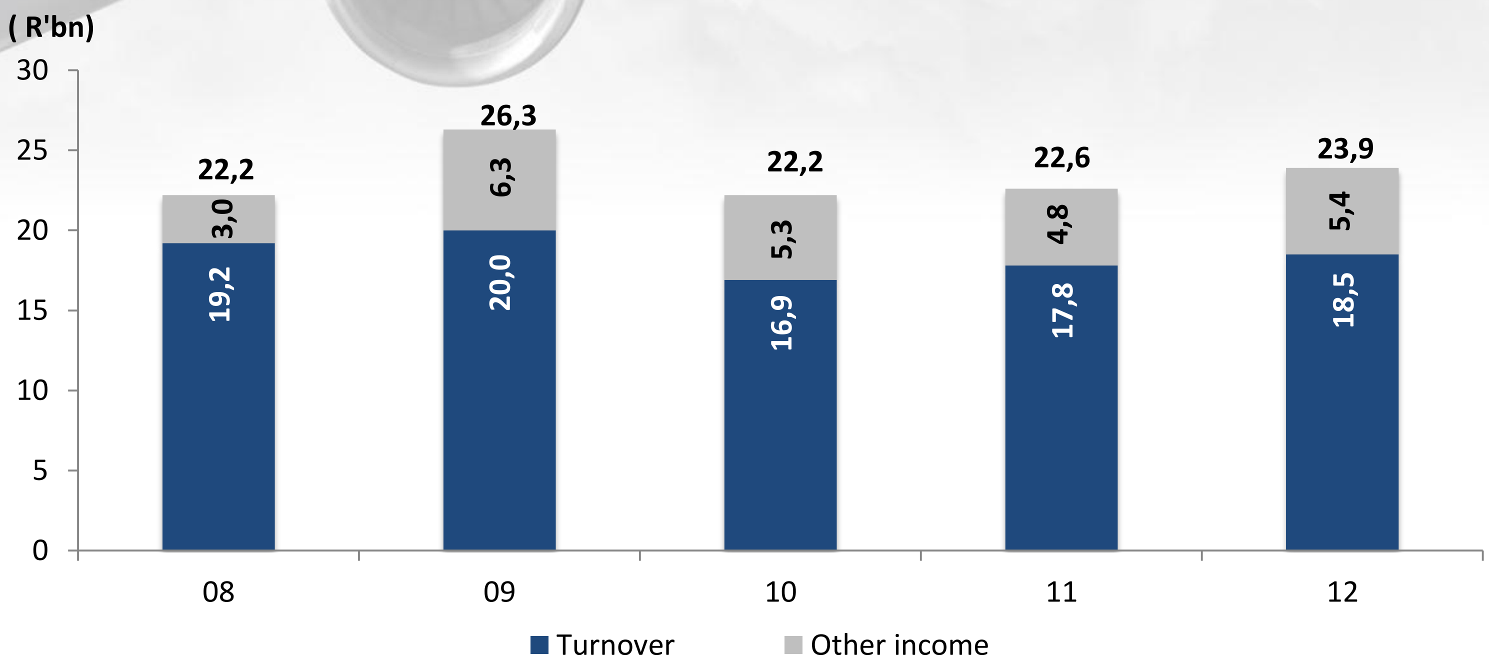
- Total revenue up six percent despite persisting market pressure
- Controllable costs up 5%
  - Excludes costs such as:
    - Fuel costs
    - Maintenance costs
    - Regulated costs
- Revised accounting policies adopted in line with industry best practice and in accordance with IFRS
- R935 million gain on revaluation of Group property
- Shareholder guarantee of R5bn

# Shareholder Guarantee

- Approved a R5 billion Going Concern Guarantee
- R1.544 billion available to raise working capital
- Balance will be contingent on the identified risks materialising
- Conditions
  - SAA to report on the utilisation of guarantee – working capital, risk adjustments and sensitivities
  - Approval from Minister of Finance for terms of financing
  - Submission of approved turnaround plan, including funding plan for both short and long haul fleet
- Previous R1.2 billion guarantee still in tact

# Revenue Analysis

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| Turnover | 18,450 | 17,767 | ↑4% |
| Other Income | 5,411 | 4,841 | ↑12% |
| **Total Revenue** | **23,861** | **22,608** | **↑ 6%** |

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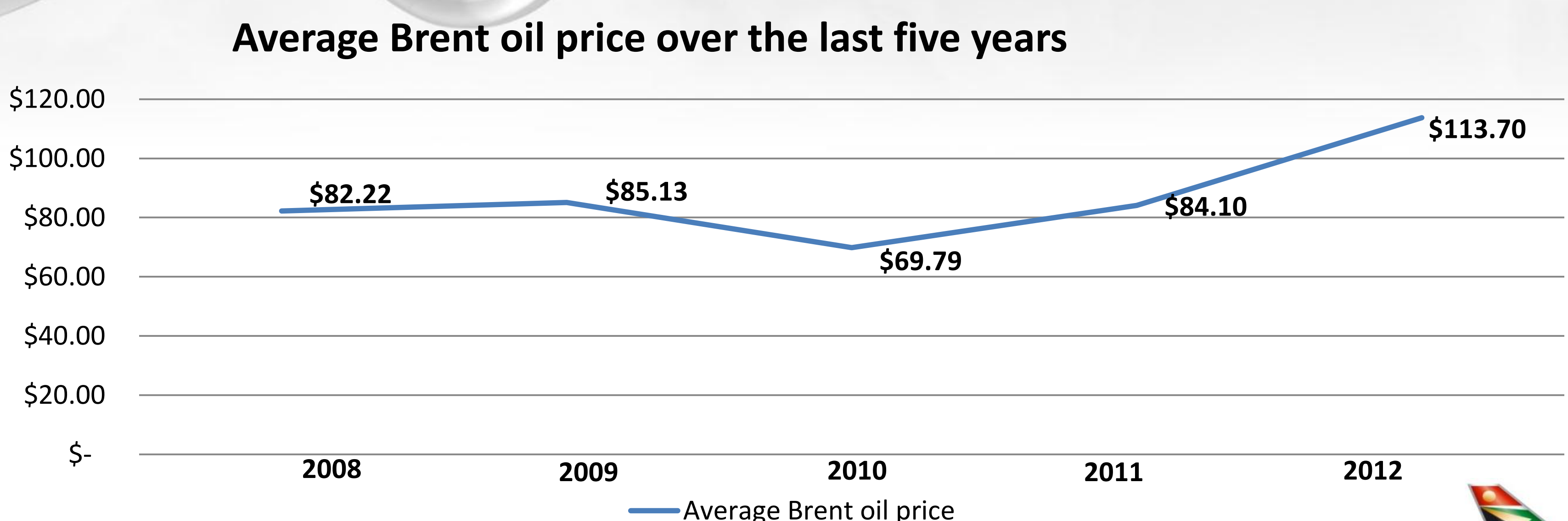
# Operating Costs

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| Fuel | 8,302 | 6,086 | ↑ 36% |
| Employee Expenses | 4,711 | 4,417 | ↑ 7% |
| Aircraft Maintenance | 1,739 | 1,316 | ↑32% |
| Aircraft Lease Costs | 1,797 | 1,686 | ↑ 7% |
| Navigation, Landing & Parking | 1,476 | 1,248 | ↑ 18% |
| Other Operating Costs | 7,151 | 6,849 | ↑ 4% |
| **Total Operating Costs** | **25,176** | **21,602** | **↑ 17%** |

# Operating Costs (cont)

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| Fuel | 8,302 | 6,086 | ↑ 36% |

- Average Brent crude price increased by 35.2% - $84.10 to $113.70 per barrel
- Comprised 33% of total operating expenditure (2011: 28%)

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# Operating Costs (cont) – Employee Expenses

**<u>Increase R294 million (+7% )</u>**

- Increase excluding pension fund adjustments – 4%

| Headcount: | 2011-12 | 2010-11 | Variance |
|---|---|---|---|
| South Africa | 10,479 | 10,057 | +4% |
| International | 565 | 557 | +1% |
| **Total** | **11,044** | **10,614** | +4% |

# Operating Costs (cont) – Aircraft Maintenance

**Increase R423 million (+32% )**

- Foreign currency translation movements on Maintenance Provision for leased aircraft
- Removing the effect of the currency fluctuation - decrease of 1%

# Operating Costs (cont) – Aircraft Lease Costs

## Increase R111 million (+7% )

- The increase is a combination of currency movements as well as higher lease charges on new replacement aircraft

| Leased Fleet at 31 March 2012 | | | | |
|---|---|---|---|---|
| | **2012** | **2011** | **Change** | |
| A330 | 6 | 2 | 4 | 4 additional A330-200's |
| B737 | 23 | 25 | (2) | 2 B737-800's leases terminated |
| A319 | 11 | 11 | - | |
| A320 | 2 | - | 2 | 2 additional A320-200's |
| A340 | 11 | 16 | (5) | 5 A340-200's leases terminated |
| **Total** | **53** | **54** | **(1)** | |





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# Operating Costs (cont) – Navigation, Landing and Parking

**<u>Increase R228 million (+18% )</u>**

- ACSA increase year on year was R129 million (34%) on top of a 34% increase in the previous year
- Other Navigation, Landing and Parking Fees increased by R99 million (11%)





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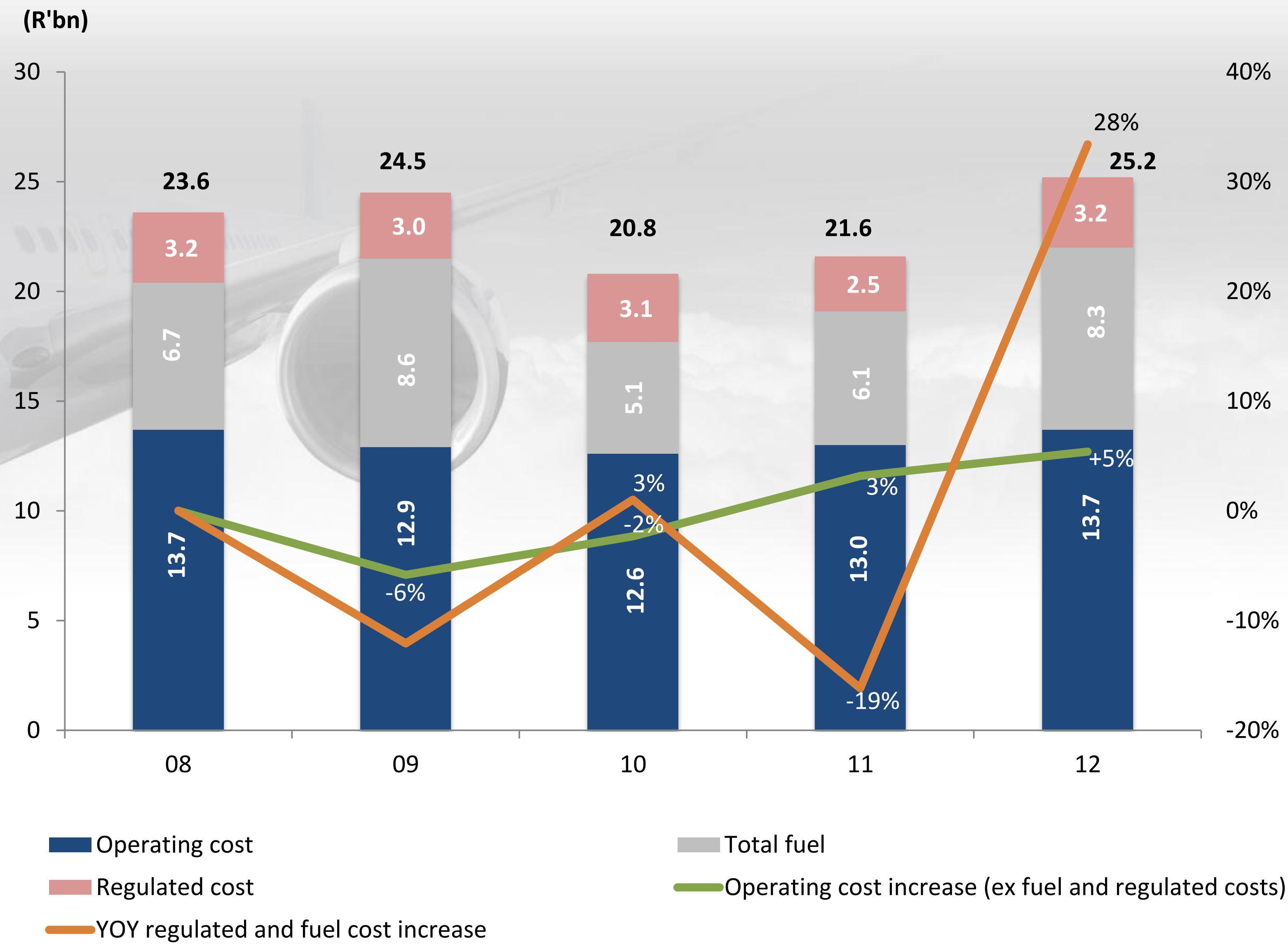
# Analysis of Group Operating Costs – (cont)

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# Statement of Comprehensive Income

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| Total Revenue | 23,861 | 22,608 | ↑ 6% |
| Operating Costs | (25,176) | (21,602) | ↑ 17% |
| **Operating (Loss)/Profit** | **(1,315)** | **1,006** | **↑>100%** |

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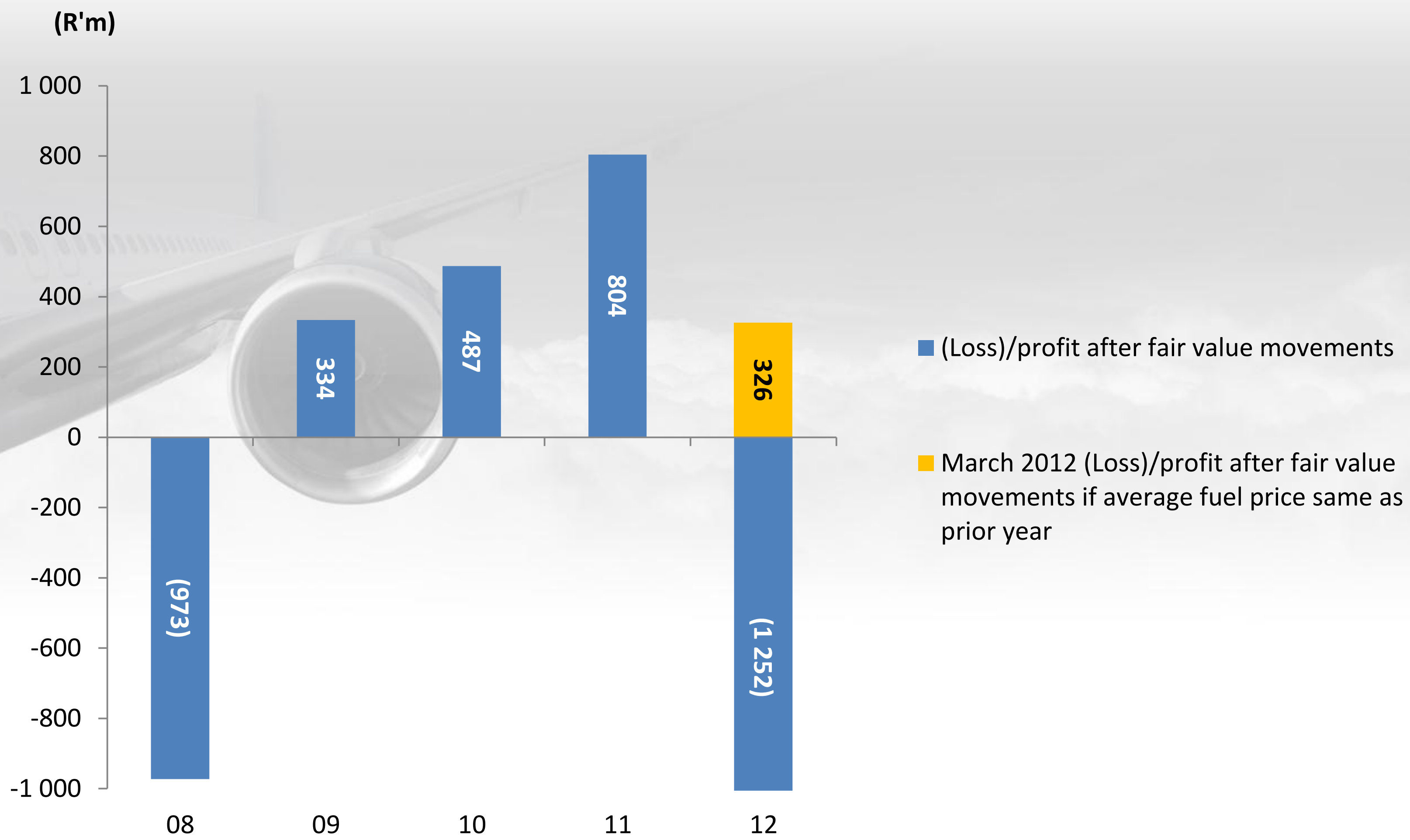
# Operating Profit/(Loss) after fair value movements

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# Statement of Comprehensive Income (cont.)

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| Total Revenue | 23,861 | 22,608 | ↑ 6% |
| Operating Costs | (25,176) | (21,602) | ↑ 17% |
| **Operating (Loss)/Profit** | **(1,315)** | **1,006** | **↓ >100%** |
| Fair Value & Translation Profit/(Loss) | 63 | (202) | ↑ 131% |

# Fair value movements and translation profit/(loss)

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| **Translation profit/(loss) on foreign assets and liabilities** | **81** | **(309)** | ↓ >100% |
| **Net fair value (loss)/gain on hedging instruments** | **(18)** | **107** | ↓>100% |
| - Realised loss on derivatives | 96 | (182) | ↓ >100% |
| - Fair value (loss)/gain on derivative financial instruments | (114) | 289 | ↓ >100% |
| **Total fair value movements and translation losses** | **63** | **(202)** | ↓ >100% |

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# Fair value movements and translation losses – Hedging policy

The hedging strategy and programme is guided by it’s conservative hedging policy.

- Currency hedging limits – hedging net currency exposure with a maximum of 75% of future exposures.

- Fuel hedging limits – hedging to a maximum of 60% of budgeted exposure maximum of 12 months forward.

# Statement of Comprehensive Income (cont.)

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| Total Revenue | 23,861 | 22,608 | ↑ 6% |
| Operating Costs | (25,176) | (21,602) | ↑ 17% |
| **Operating (Loss)/Profit** | **(1,315)** | **1,006** | **↓ >100%** |
| Fair Value & Translation Profit/(Loss) | 63 | (202) | ↑ 131% |
| **(Loss)/Profit before Finance Costs & Investment Income** | **(1,252)** | **804** | **↓>100%** |
| Finance Costs & Investment Income | (105) | (12) | ↑>100% |
| **(Loss)/Profit Before Taxation** | **(1,357)** | **792** | **↓ >100%** |
| Taxation | 514 | (13) | ↑>100% |
| **(Loss)/Profit for the year (after tax)** | **(843)** | **779** | **↓>100%** |

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# Statement of Comprehensive Income (cont.)

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| **(Loss)/Profit for the year (after tax)** | **(843)** | **779** | **↓>100%** |
| **Other Comprehensive Income** | **903** | **(32)** | ↑ >100% |
| Actuarial gains/(losses) | 80 | (32) | **↓>100%** |
| Revaluation of Property | 823 | - | ↑ >100% |
| **Total Comprehensive Income** | **60** | **747** | ↓92% |

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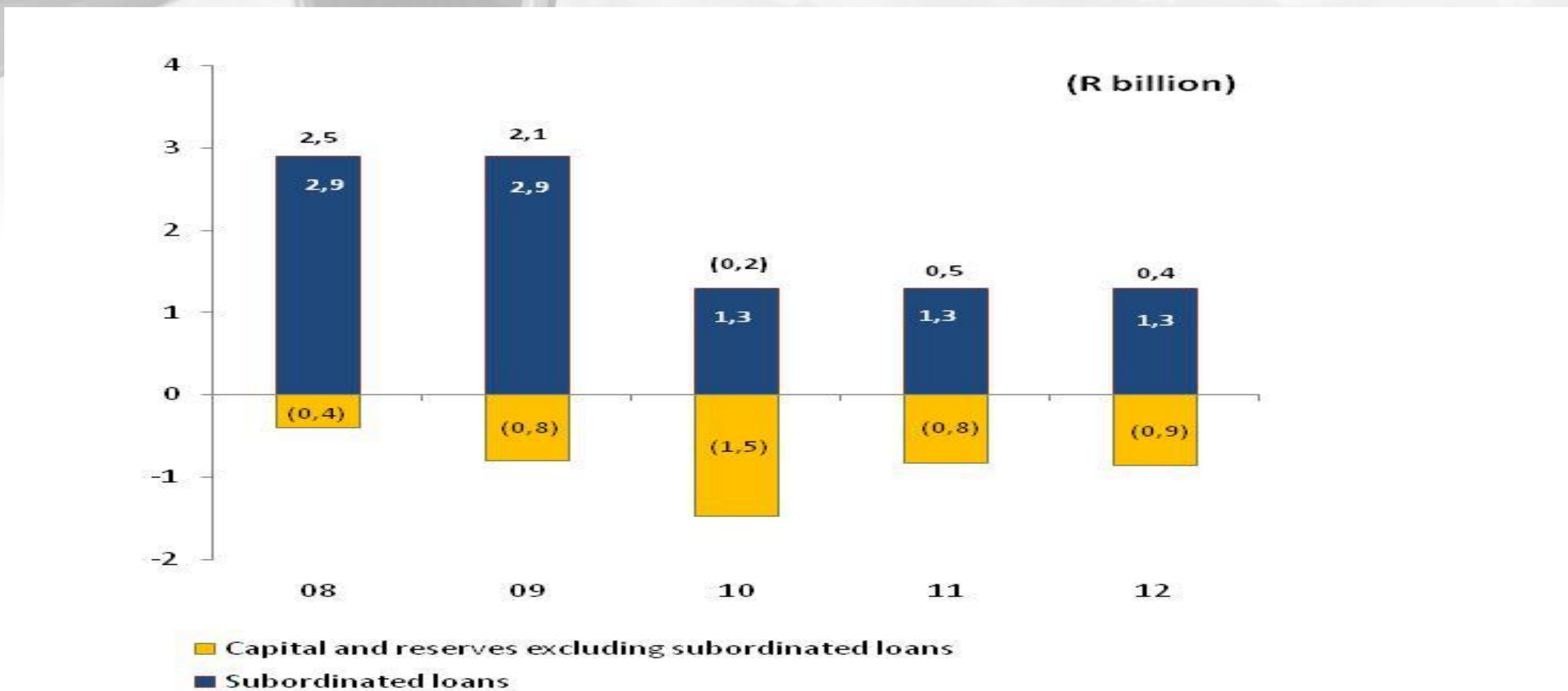
# Statement of Financial Position

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| Capital and Reserves | (857) | (825) | ↓4% |
| Subordinated loan | 1,300 | 1,300 | - |
| **Total Capital and Reserves** | **443** | **475** | ↓7% |






AIRWAYS

# Statement of Financial Position

| | 2011-12 | 2010-11 (Restated) | Variance |
|---|---|---|---|
| **Total Non-current assets** | **7,833** | **6,380** | ↑23% |
| **Total Current Assets** | **5,654** | **7,764** | ↓27% |
| Cash & Cash Equivalents | (33) | 2,252 | ↓>100% |
| Other Current Assets | 5,687 | 5,512 | ↑3% |
| **Total Non-current Liabilities** | **3,961** | **4,182** | ↓5% |
| Long –Term Loans | 1,305 | 1,671 | ↓22% |
| Other Non-current liabilities | 2,656 | 2,511 | ↑6% |
| **Total Current Liabilities** | **9,083** | **9,487** | ↓4% |
| **Net Assets** | **443** | **475** | ↓7% |

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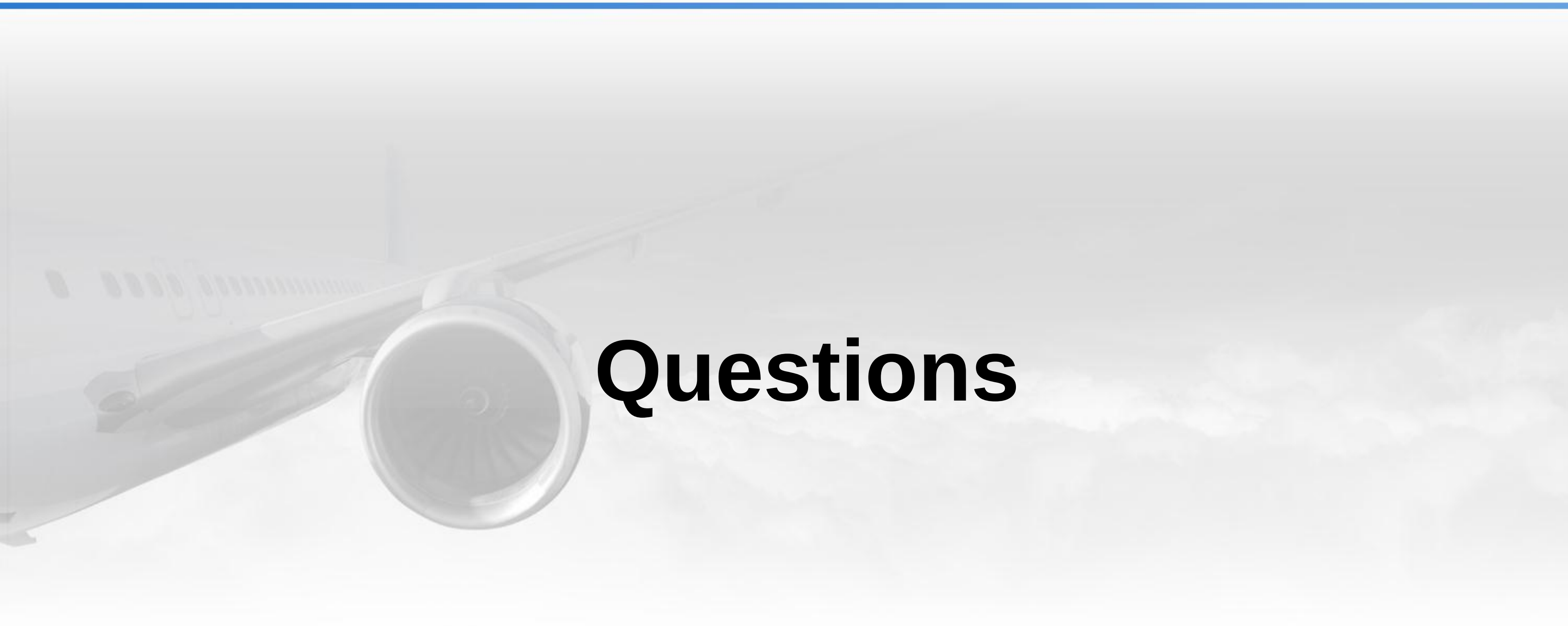
# Cashflow

| | 2011-12 | 2010-11 |
|---|---|---|
| Net Cash and cash equivalents | (33) | 2,252 |

1. Net cash of R1.6bn utilised in operating activities – fuel expense increased by R2.2bn from previous financial year.
2. Net Fleet additions of R536m during the current financial year.
3. Repayment of R644m on Long-term borrowings.
4. PDP payments of $33.2m (R248m).

# The End



## Questions