Non-Tabling of 2018/19 Annual Reports: SAA & Department of Water and Sanitation, with Deputy Ministers

Public Accounts (SCOPA)

13 November 2019

Chairperson: Mr M Hlengwa (IFP)

Meeting Summary

**Video:** SAA Engagement with SCOPA

**Video:** DWS Engagement with SCOPA

The standing committee on public accounts was briefed by South African Airways and the Department of Water and Sanitation on the non-tabling of the Annual Reports for 2018/19.

The Committee was briefed on the non-tabling of 2018/19 Annual Reports by South African Airways and the Department of Water and Sanitation. The Deputy Ministers of Public Enterprises and Human Settlements, Water and Sanitation were in attendance.

SAA reported that the options facing the airline were stark. If it had submitted financial statements on the basis of being a going concern, it would have risked a disclaimer audit opinion from the Auditor-General, with disastrous consequences. If it had submitted on the basis of liquidation, the consequences would have been equally disastrous. The airline had received a commitment of financial support from the Department of Public Enterprises, as the shareholder, which would allow it to continue trading as a going concern according to a legal opinion they had obtained. Formal confirmation from Treasury had not been received, however. The presentation also drew attention to the impending strike over wages at the airline, and the serious costs and knock-on effects it would have.

The Committee was critical of the board’s refusal to shoulder the risk of a disclaimer audit opinion. Members accused the board of violating the Public Finance Management Act by refusing to submit financial statements. They expressed concern about the precedent that would be set if they gave the airline the support it needed. For their part, the airline insisted that they had acted in accordance with legal advice. They also drew attention to the disastrous consequences that they were facing. It was agreed that a roadmap for submission of the financial statements would be presented to the Committee on 27 November 2019.

The Department of Water and Sanitation explained that its main account had been audited. The delay had been with a separate water trading account linked to the Trans-Caledon Tunnel Authority. There had been a difference in interpretation with the Auditor-General over the nature of the documents required to substantiate payments made to various entities involved in the Lesotho Highlands Water Project. This would have resulted in a qualified audit opinion. The outstanding issues had been resolved and it had submitted its annual financial statements, which were expected to be fully audited by 31 December 2019.

Members were generally satisfied with the explanation and commitments presented by the Department.

The Committee noted, however, that it did raise the question of how monthly and quarterly reporting had been handled.

---

Meeting report

The meeting had been scheduled to start at 9:00am but due to a miscommunication it started shortly before 9:30am.

**Opening Remarks**

The Chairperson accepted apologies from the Minister of Human Settlements, Water and Sanitation Ms Lindiwe Sisulu, Minister of Public Enterprises Mr Pravin Gordhan. It was the view of the committee, he said, that non-submission of annual reports was unacceptable and could not be allowed to become a norm. The practice of using financial solutions to solve non-financial problems had to stop. The issue was to get management and governance right.

Deputy Minister of Public Enterprises, Phumulo Masualle and Deputy Minister of Human Settlements, Water and Sanitation, David Mahlobo were present to lead the delegations from SAA and the Department of Water and Sanitation.
Briefing by South African Airways
Deputy Minister Masuwalile stated that the Chairperson of the board had resigned this year. The Acting board chairperson was Ms Thandeka Mgodu... 

Ms Mgodu introduced the delegation from SAA and asked if a few items concerning recent developments (wage demands from labour unions and an impending strike) could be added to the agenda.

The Chairperson said that they could be addressed at the end of the meeting if there was time. The core business of the meeting was the non-tableing of the Annual Report.

Mr Martin Kingston, Non-executive Director, SAA, said that a lack of access to liquidity was SAA's fundamental problem. SAA was technically insolvent, and no assurance could be given that it was a going concern. He acknowledged the support that government had offered but regretfully it was not sufficient. He could not give a date for when SAA would be able to submit its financial statements to the Committee. If SAA prepared financial statements on the basis of being a going concern, there was a risk of receiving a disclaimed audit opinion, which SAA was not prepared to shoulder. The other option was to prepare financial statements on the basis of liquidation, but this would have catastrophic consequences. For example, it would result in over R40bn in obligations needing to be settled immediately and the government would lose all control over the company. SAA could only continue as a going concern if it received a capital injection or a government guarantee to lenders from National Treasury. The Department of Public Enterprises, as shareholder, had confirmed its ongoing support of SAA but no formal confirmation from Treasury had been received. The risks of ceasing to be a going concern included immediate settlement of debts, negative impacts on trade and travel, and the loss of 10 000 direct and over 40 000 indirect jobs. The board had sought legal advice, which had assured it that, given the confirmed support from the shareholder, it was not trading recklessly in violation of Section 22 of the Companies Act. Mr Kingston said that the threat of a strike was pushing SAA toward a precipice. The cost of a strike would be over R50m per day, even without accounting for the effects of the loss of confidence it would cause.

Mr Deon Fredericks, Chief Financial Officer, SAA, said that SAA was in discussion with lenders to secure R2bn in working capital. The lenders had agreed in principle, conditional on a government guarantee. The trading environment was very challenging, and SAA was looking for additional revenue whilst aggressively reducing costs and stopping all non-essential expenditure. Looking at SAA's audit status, 72% of the findings from the 2017/18 audit had been cleared. The draft financial statements for 2018/19 had not been approved by the board because of concerns about its going concern status, and the Auditor-General had agreed to wait until the issue was resolved.

Discussion
Mr A Lees (DA) said that the situation seemed very bleak. He asked why the board was not considering business rescue as an alternative to trying to continue as a going concern or liquidation.

Mr Kingston replied that the board had discussed business rescue extensively. It could not be done without shareholder consent, however, and according to legal advice the board had received, business rescue would have the same liquidity requirements as trying to continue as a going concern.

Mr Lees argued that if the liquidity requirements were the same, business rescue must still surely be an option.

Mr Kingston replied that it would be an option only if SAA could get access to the capital it needed. There were also ramifications for some existing agreements such as leases. They had received a legal opinion that it was not an option.

Mr Lees asked for a copy of the legal opinion.

The Chairperson asked for it to be made available to the Committee by Wednesday, 20 November 2019 at 12:00pm.

Mr Lees said that it appeared that the board had been allowing SAA to trade as a non-going concern for at least 18 months.

Mr Kingston replied that there was a difference between having an assurance from the Department as shareholder to provide the requisite financial support and actually having the finances and business prospects to qualify as a going concern. SAA had been and was in the first situation, and in the past the requisite support had been provided at the last moment.

Mr Lees replied that the board still appeared to be flouting the Public Finance Management Act (PFMA) by not submitting annual financial statements. The assurances of support by the shareholder simply could not override the PFMA. SAA had
not been a going concern and had therefore been trading recklessly.

Ms Mgoduso disagreed that the PFMA had been flouted. SAA had received unequivocal support from the shareholder and a legal opinion that this was sufficient.

Mr Lees insisted that the PFMA made no provision for financial statements to be withheld on the basis of any promise of support. He asked for copies of the support promised by the shareholder and the legal opinion that it was sufficient.

The Chairperson asked for these copies to be made available to the Committee by Wednesday, 20 November 2019 at 12:00pm. He said that non-submission of financial statements was non-compliance with the PFMA from the Committee’s perspective, particularly when it became a trend. He reminded the board the shareholder was the South African taxpayer, and the board could not keep demanding money from them.

Ms N Tolashe (ANC) was not convinced that SAA had not broken any law by not submitting financial statements and asked Ms Mgoduso to elaborate. She also asked what kind of restructuring was being considered by the board. It needed to get its affairs in order or quit.

The Chairperson added that oversight mechanisms were being ignored. Could the board give any assurance that the same thing would not happen next year? Non-submission could not become a norm. The Committee had to be enabled to hold SAA accountable. The board needed to stop relying on circumstances outside of its control.

Mr S Somyo (ANC) was very critical of the board’s refusal to shoulder the risk of a disclaimed audit opinion. They were either arrogating the responsibility of the executive authority or of Parliament. The board was essentially only considering itself. It would be reckless for Parliament to continue supporting SAA in the absence of financial reporting.

Mr Fredericks began to explain how serious a disclaimed audit opinion was.

Mr Somyo interrupted. The board needed to do what it was employed to do, and shoulder the risk.

The Chairperson said that the particular phrasing in the presentation was causing the Committee anxiety.

Mr Fredericks apologised if the presentation had seemed disrespectful, but the house was on fire. If SAA received a disclaimed audit opinion, no flight would take off the next day.

Deputy Minister Masuale called for a holistic view of the situation. He said there had not been any expectation that delays in reporting would go on for so long. The particular situation of SAA would mean that a disclaimed opinion on the basis of not being a going concern would have the knock-on effect of paralysing operations. He called for a meeting of minds to reconcile the realities facing SAA with the duties of Parliament.

The Chairperson explained that the Committee’s problem was that it could not perform oversight without the financial statements.

Mr Kingston said that financial statements could be prepared on only two bases: going concern or liquidation. It was the board’s responsibility to choose between them. A disclaimed audit opinion would be effectively the same as liquidation.

The Chairperson replied that the Committee was not trying to tell the board how to prepare its financial statements; it just wanted a road map for their submission. The Committee appreciated the complexities facing SAA but could not allow it to continue operating without oversight. He supported the Deputy Minister’s call for a meeting of minds to chart a road map for submission.

Ms Mgoduso also supported this call.

Mr Lees objected to Mr Kingston. He said it was for the facts to decide whether SAA was a going concern or not. In either case, the board was obliged to prepare the financial reports, regardless of the consequences.

Mr Somyo said the Committee could not weigh the merits and demerits of the board’s options. The important point was, if the Committee was to approve the funds for SAA, on what basis would it be, given that they had not submitted financial statements?

The Chairperson added that compliance could not be cherry-picked. The fundamental point was that compliance was the condition for support from parliament. It was difficult to accept that SAA did not even know when it would be able to submit. It could be in 2024!
Mr M Dirks (ANC) said that the problem was that the board was running away from a disclaimed audit opinion. How could the Committee approve funding without seeing the financial statements? He also felt that the particular phrasing in the presentation had made the committee angry.

The Chairperson added that there were knock-on effects of complying with SAA’s requests. It would set a precedent for other entities, who would demand the same leniency.

Mr B Hadebe (ANC) asked when SAA was going to submit the financial statements. The PFMA did allow for it to give reasons for a delay, but not a simple refusal. What law authorised the board of SAA to not submit financial statements for two years?

Ms Mgoduso replied that SAA had not refused. It had consulted with the shareholder and sought a legal opinion.

Mr Hadebe disagreed. What gave SAA the right to delay the submission indefinitely?

Deputy Minister Masuille suggested that the Department come back with a proposal for a road map for submission.

Mr Hadebe asked for details on the restructuring of SAA. The board was saying, indirectly, that it had lost hope of coming up with sustainable turnaround strategies. Was there a turnaround strategy or was SAA expecting to go on relying on bailouts?

The Chairperson noted that the main issue of the meeting was the non-submission of the financial statements. He asked for the board to include a restructuring plan in the road map but did not allow the issue to be discussed in the meeting.

Ms T Marawu (ATM) felt that the Chairperson was being very lenient towards SAA. The company haven’t even committed to a date for the road map.

The Chairperson announced that there would be a meeting on 27 November 2019 at 6pm. The Department of Public Enterprises, National Treasury, the Auditor-General and SAA would be present. A roadmap for submission and answers to members’ questions would be expected. No request to the house would be submitted before the meeting, as the committee needed to ensure that non-submission of financial statements did not become entrenched as a norm. Everyone was committed to seeing that SAA was functional, effective and efficient, but there were terms and conditions to the government’s support.

Ms Avril Halstead, Deputy Director General: Transportation and Defence, Department of Public Enterprises, stressed the dire ramifications for the fiscus of either a disclaimed audit opinion or liquidation.

The Chairperson warned that SAA should not try and justify its non-submission at the meeting on the 27th.

Ms Mgoduso said that SAA was in the middle of a challenging period but there was a long-term turnaround strategy. There was onerous legislation governing pilots and crew which were being looked at in consultation with the Pilot’s Association. Pilots were entitled to yearly salary increases regardless of whether they were affordable, and unions were demanding the same increase. It was time to start talking about salary sacrifices.

Mr Kingston acknowledged the board’s non-compliance. The core issue is the financial viability of SAA, which depended on revenues and costs, and the competition was fierce. He assured the committee that the board was doing everything to avert a strike, but it would not be at the expense of the South African public.

Deputy Min Masuille welcomed the guidance of the committee. It was beginning to sink in that state-owned enterprises could not be allowed to continue being a drain on the fiscus. They needed to become agile and fit for purpose.

The Chairperson said that the Department of Water and Sanitation had been summoned because it had failed to meet its own deadline for the submission of the Annual Report of the Trans-Caledon Tunnel Authority (TCTA). He criticised the Department for sending the presentation on the day of the meeting.

**Briefing by the Department of Water and Sanitation**

Deputy Minister Mahlobo introduced the delegation and apologised for not sending the presentation earlier. He explained that the Department’s main account had been audited. The delay had been with a separate water trading account linked to TCTA. The outstanding issues at TCTA had been resolved and it had just submitted its annual financial statements.
Mr Mbulelo Tshangana, Acting Director-General, Department of Human Settlements, Water and Sanitation, explained that TCTA was the vehicle for all of the Department's projects in South Africa and abroad, notably phase 2 of the Lesotho Highlands Water Project, which the Minister was launching today. These projects were sometimes very complex and involved numerous agencies working together. Nevertheless TCTA had a track record of good audit results, he said, but the deadline they had set themselves this year had been too ambitious.

Mr Percy Sechemane, Chief Executive Officer, TCTA, explained that there had been a difference in interpretation between the Auditor-General and TCTA over the nature of the documents required to substantiate payments made by TCTA to various entities involved in the Lesotho Highlands Water Project (LHWP), which would have resulted in a qualified audit opinion. He discussed the background of the LHWP, noting the complex financial and governance arrangements involving the Kingdom of Lesotho. These complexities required a unique accounting treatment. Since 2012 TCTA had used International Accounting Standard 11 (IAS 11), but it did not reflect the true nature of the transactions between TCTA and the other entities. The Auditor-General had not been comfortable with changing the standard. Revised financial statements had been submitted on 21 October 2019. The Auditor-General indicated that it would begin its audit on 15 November, with a release planned by 31 December 2019. He said that a qualified audit opinion might have led to TCTA's outstanding borrowings of R22bn becoming immediately repayable and even de-listing from the Johannesburg Stock Exchange.

Discussion
Mr Somyo suggested that a workshop should be held between the entities on either side of the border to ensure a seamless basis for accountability of the LHWP.

Mr Somyo was relieved that the financial statements had been submitted to the Auditor-General.

Ms Toloshe took comfort from the Acting Director-General's assurances that the situation would not arise again.

Mr Lees said the situation at TCTA was similar to the one at SAA: the board had taken it upon itself to withhold financial statements to avoid an adverse audit finding. While the Minister could inform Parliament of delays, he was not sure that the board had this power, and looked forward to clarity on the matter.

Mr Hadebe disagreed that the TCTA situation was similar to SAA. TCTA had given specific reasons for the delay. There had been no deliberate attempt not to submit.

Deputy Minister Mahlobo also denied that the situations were equivalent. There was a need for clarity on accounting of transnational agreements, though.

The Chairperson accepted the explanation given by the Department. It did raise the question of how monthly and quarterly reporting had been handled. The Committee would also look at the roles, powers and functions of the board. The Committee would hold the Department to its timeline commitments.

Committee Matters
The Chairperson informed the Committee that the German Parliament had invited it for a visit and had suggested 14-21 January 2020 as new dates, or in April. The Committee would meet with the Department of Correctional Services on 19 November at 9:30 and with the Passenger Rail Authority of South Africa on 20 November at 9:00. He asked members to submit suggestions for the content of the meeting with SAA on 27 November.

The meeting was adjourned.
SAA outstanding matters: update, with Minister

Public Accounts (SCOPA)

19 February 2020

Chairperson: Mr M Hlengwa (IFP)

Meeting Summary

Public Finance Management Act

06 December 2019 - SAA business rescue process
05 December 2019 - SAA to enter into business rescue

The Standing Committee on Public Accounts (SCOPA) held a joint meeting with the Portfolio Committee on Public Enterprises to receive an update on the state of affairs at South African Airways from the Minister of Public Enterprises, staff at South African Airways and the business rescue practitioners appointed to the airliner.

The Minister requested that no questions on the business rescue plan or investigations be directed at the business rescue practitioners as their work was confidential until approved by the creditors. The briefing by officials gave some background on how SAA had ended up in business rescue on 6 December 2019, and the implications of being in business rescue, as well as the relevant sections of the Companies Act. SAA was the first public entity to be placed in business rescue and a lot of lessons would be learnt by government and business rescue practitioners in the cross-matching of the Companies Act and the Public Finance Management Act. The Annual Financial Statements for 2017/18 and 2018/19 had not been provided within one month of the Audit Report as required by the Public Finance Management Act but the Minister had, lawfully in terms of section 65(2) of that Act, delayed the tabling of the Reports. If the Annual Reports were tabled, they would effectively place SAA in liquidation.

The Minister added that once the board of SAA had come to the view that the entity was in financial distress, the board had to determine whether to restructure, go into liquidation or go into business rescue. In recent times, SAA had relied heavily on the private sector for funding and, at that time, funding was only available if SAA went into business rescue. SAA then required post-commencement finance to sustain it during the process of business rescue. After doing an assessment, the business rescue practitioners had come to the view that the entity was rescueable but not as it existed at that moment due to corruption, poor management, mismanagement, poor choices of aircraft and the fact that most aircraft were leased which meant that there was a base cost for every flight. The current funding would be sufficient to carry the Airways through to early March, which was when the report by the business rescue practitioners was due.

The Committee was aware of the provisions allowing a Minister to provide reasons for not submitting an Annual Financial Statement but the Committee was not in agreement with a prolonged non-submission of annual financial statements. It had been two years and the Committees wanted SAA to develop a roadmap for submitting financial statements. Members wanted to interact with that process. Despite protestations from SAA that it was not possible to submit financial statements, the Committee remained fundamentally and unequivocally resolved that financial statements be submitted so that SCOPA was in a position to fulfil its oversight role as per the parliamentary rules. The provision in the Public Finance Management Act giving an entity authority to give reasons for not tabling financial statements, did not give the entity authority never to table the Annual Financial Statements. Ultimately, the Minister agreed to discuss the possibility of providing management accounts in the interim. He also proposed that all Members of Parliament and all government officials be requested to fly SAA in order to improve passenger numbers and revenue.

Members had many questions for the Minister and the officials. What were the consequences for the people who had failed to carry out their duties in the entity? How much funding did SAA now require? Could the Minister perhaps inform the Committees of some of the lessons learned and the interaction of the Companies Act and the PFMA? To what extent were there aviation experts advising the business rescue practitioners? There was a shortfall of R2 billion in 2016 and now the shortfall was R4 billion. What informed that increase?

A Member asked if the State-owned Enterprises were not just grandiose welfare institutions. Would the economy not be better served by allowing private business to take over and running the companies according to the needs in the market? Members were concerned that flights on the extremely busy route from Johannesburg to Durban had been cancelled while flights on the minor route from Johannesburg to Nelspruit had been retained. What was going on? Lastly, Members asked what the intentions were regarding labour.

Members suggested that Parliament needed to address the loophole in section 65(2) of the Public Finance Management Act or more entities would use that loophole and there would be nothing Parliament could do.
The Chairperson declared the meeting suspended, not closed. He maintained that the Committees needed to hear from the business rescue practitioners. Their work had to be concluded by 6 March 2020 and a date would be set for the business rescue practitioners as the Accounting Authority to appear for a full hearing. SAA could not venture into any new arrangement without SCOPA hearing from the business rescue practitioners who were responsible for the transitional period. SCOPA would map out the way forward. SAA remained at the centre of parliamentary focus and SCOPA awaited financial details from SAA.

Meeting report

Opening Remarks

The Chairperson welcomed everyone to the joint meeting of the Standing Committee on Public Accounts (SCOPA) and the Portfolio Committee on Public Enterprises. The meeting was being held to obtain a briefing on the state of affairs at South African Airways (SAA).

Adv S Swart (ACDP) noted that the presentation sent by SAA was marked “Secret” but the meeting was open to the public.

The Chairperson responded that SAA would address that issue when it made the presentation.

Remarks by the Minister of Public Enterprises

Minister Pravin Gordhan apologised for the quality of his voice as he had laryngitis, but he assured the Committees that, other than that, he was fighting fit. He added that the document was no longer secret. SAA had been requested by SCOPA to provide an update on its status and would make a presentation that would give some background on how it had ended up in business rescue on 6 December 2019, and the implications of being in business rescue as well as the relevant sections of the Companies Act. SAA was the first public entity to be placed in business rescue and so a lot of lessons would be learnt by government and business rescue practitioners in the cross-matching of the Companies Act and the Public Finance Management Act (PFMA). SAA was prepared to respond to any other issues that the Committees might have.

The team of business rescue practitioners had been requested to be present but they could not answer questions on the business rescue plan or investigations. The business rescue practitioners were developing a business rescue plan and when it is approved, it would be made public. The Minister asked, respectfully, that Members not address any such questions to the practitioners.

Presentation by SAA

Mr Melanchton Makobe, Acting Deputy-Director General, DPE, presented the report to the Committees. He was supported by the Acting Director-General (ADG), Kgathatsi Thlakudi and the Chief Director: Head of Aviation, Ms Nonny Mashika.

Mr Makobe explained that performance at SAA had deteriorated in the 2019/20 financial year leading to business rescue as liquidation was not a viable option. The business rescue practitioners were developing a business rescue plan inclusive of restructuring and, in the interim; the government was providing post-commencement finance (PCF) to sustain operations. He detailed the events leading to business rescue and noted that Mr Les Matsum and Mr Siviwe Dongwana had been appointed as joint business rescue practitioners.

Mr Makobe detailed the implications of liquidation and why it was not viable. He also explained the implications of business rescue as well as the powers of the shareholder, board and business rescue practitioners and how business rescue came to an end.

Way forward

The Annual Financial Statement had not been provided within one month of the Audit Reports but the Minister had, lawfully, delayed tabling of the AFP. If the Annual Reports were tabled, they would effectively place SAA in liquidation.

Section 65 of the Public Finance Management Act No 1 OF 1999 stated: Tabling in legislatures. — (1) The executive authority responsible for a department or public entity must table in the National Assembly or a provincial legislature, as may be appropriate—

(a) the annual report and financial statements referred to in section 40 (1) (d) or—

55 (1) (d) and the audit report on those statements, within one month after the accounting officer for the department or the accounting authority for the public entity received the audit report;
(2) If an executive authority fails to table, in accordance with subsection (1)(a), the annual report and financial statements of the department or the public entity, and the audit report on those statements, in the relevant legislature within six months after the end of the financial year to which those statements relate—

(a) the executive authority must table a written explanation in the legislature setting out the reasons why they were not tabled.

Ministerial conclusion

The Minister stated that SAA went into business rescue formally on 6 December 2019. It was the board that had determined that business rescue was the way to go. Once the board had come to the view that SAA was in financial distress, the board had to determine whether to restructure, go into liquidation or business rescue. In recent times, SAA had relied heavily on the private sector for funding and, at that time, funding was only available if SAA went into business rescue. SAA then required PCF (post-commencement funding) to sustain it during the process of business rescue. After doing an assessment, the business rescue practitioners had come to the view that the entity was re-usable but not as it existed at that moment due to corruption, poor management, mismanagement, poor choices of aircraft and the fact that most aircraft were leased which meant that there was a base cost for every flight. All of those factors would be considered in the restructuring. The business rescue plan would say in what state SAA could survive as a viable business into the future and what restructuring was required.

He added that a choice would have to be made regarding which routes remained and which were discontinued and that would determine the kind of fleet required and the required staffing. There would be negotiations with lessors and other stakeholders as well as the shareholder. SAA had a very large head office and other expenses that would make many routes unprofitable. However, if one took only the core costs, some routes could be profitable. Other airlines had bought their aircraft and so did not carry ongoing costs in the way that SAA did. Those were some of the elements that would emerge from the business rescue plan. The issue was the money required in the interim. Some money had come from the fiscus, private lenders and also Development Finance Institutions (DFIs). A key issue was how those involved managed to ensure that pressure on the fiscus was reduced and the entity could grow into the future?

Discussion

The Chairperson said that he was aware of the provisions relating to annual financial statements but the Committee was not in agreement with a prolonged non-submission of annual financial statements. It had been two years and the Committees wanted SAA to develop a roadmap for submitting financial statements. The application of any provision, such as section 65, had to be rational. In the previous meeting with SAA that had been explained. The Committee remained of the view that a process had to be set into motion and Members wanted to interact with that process.

The Committee had intended to visit the board in December to discuss how it would happen but events had taken place. Whilst there was an understanding of the prevailing realities, the financial statements for SAA were required. SCOPA was duty bound to examine the financial statements. It also did not want to set a precedent that would be followed by other entities. SCOPA was not dictating when it should happen, but a process had to follow that would ensure submission of statements. The submission to delay financial statements was an exception, not a norm and so when the financial statements had not been presented for two years, going on three, it became a problem, but it was still going to happen. Fundamentally and unequivocally that was still going to happen.

Mr A Lees (DA) requested that the meeting proceed on a question and answer basis.

Given the fact that it was a joint meeting, the Chairperson determined that each Member had three questions.

Mr Lees noted that the Minister had suggested five questions per Member.

The Chairperson agreed that that could be done if the Minister was chairing the meeting.

Mr Lees stated that the provision in the PFMA giving authority for an Executive Authority to give reasons for not tabling financial statements, did not give the entity the authority not to table at all. There was a lacuna in the provision as it did not state the period in which an entity did not have to table once it had given reasons but that did not mean that SAA never had to table the statements. That was a legal issue.

Mr Lees had submitted a PAIA application but had not received a response. However, his information was that the board had resolved to liquidate the airline. Was it true that the board had taken a decision to liquidate prior to December 2019?

Mr Lees asked that the business rescue practitioners answer some questions, although not about the plan. There had not been a formal report about the matter but R2 billion had been made available in December by a bank. On what basis had the loan been made? Were further guarantees issued? Were guarantees issued with the full blessing of National Treasury...
and the Minister of Finance? When were the loans repayable? Apparently, the R2 billion had been used up by the end of January and there were reports of salaries not being paid. There were reports that the Development Bank South Africa (DBSA) had loaned SAA R5.3 billion. How long would it last, when would it have to be paid, and by whom?

Ms N Mente-Nqweniso (EFF) understood that it was a joint Committee meeting so they could ask about financial as well as general matters. Members had heard about why the bailout was required but there was no detail regarding why the money was required and what the money would be used for. In the last Annual Financial Statement (AFS) tabled in Parliament in 2016/17, the shortfall was only R2 billion. The Committee did not know if SAA needed R5 billion, R10 billion or R20 billion, and why it was needed. In 2016/17, the income of SAA was R30 – R31 billion and operations were around R33 billion. There was a plan in place in 2018 to deal with all the issues raised in the meeting by the Minister.

As far as Section 65 was concerned, Ms Mente stated that the Minister ought to have put systems in place and ensured that there were consequences for the people who had failed to carry out their duties in the entity. How much did SAA now require? It had been R2 billion in 2017 but had risen to the current point. The Committee had even identified a logistic company that was situated at the airport alongside SAA Technical, that was not needed but was contracted to manage SAA’s own equipment and it was being paid millions. It was there to manage stock bought by SAA for use by SAA Technical. The issue of spares disappearing at SAA Technical had never been dealt with. The Committees needed to know what had happened. She agreed that that SAA had to be saved, and she agreed with putting SAA into business rescue. However, money could not be thrown down the drain. Could SAA please explain what had happened to those involved? Had there been consequences?

Ms Mente noted that SCOPA had met with the board and there had been a proper plan, but now everything was spiralling and the plan was not implemented.

Mr G Cachalia (DA) noted that, in terms of the appointment of the business rescue practitioners, a report was required and clearly an extension had been given but, in the interim, it was reasonable to ask, not with specific regard to the plan because that would come later, what had led to the rationale for the direction chosen in the binary choice between liquidation and restructuring. Clearly restructuring had been chosen. Could the Minister share some information about what had informed their belief to make that particular choice under a certain set of circumstances? Could the business rescue practitioners unpack some of those circumstances so that Members could be wiser? The presentation that the Committees had received was clearly procedural and in the public domain and did not take the Committees further.

Adv Swart noted that the Minister had said that the Members knew about the background to SAA from the Zondo Commission and the delinquency trial of the former board chairperson and that it was the first entity to be placed under business rescue. Could he perhaps inform the Committees of some of the lessons learned and the interaction of the Companies Act and the PFMA? It was unchartered territory and Parliament needed to exercise its oversight even though the business practitioners had taken over as accounting officers. It was a challenge, understanding that the plan to be produced would have to be discussed but there were critical issues such as the discontinuation of routes and the possible sale of aeroplanes. The Committees needed to engage on those issues. When the Portfolio Committee had met the board, it had said there would be large capital injections. Members saw now that there was a degree of capital injections and a key question was how long those capital injections would last. Considering that it was unchartered territory, to what extent were there aviation experts advising the business rescue practitioners?

Mr B Hadebe (ANC) stated that his interest was in the financials. In terms of section 65 (1) and (2) of the PFMA there was the opportunity to submit an explanation to Parliament. Nevertheless, section 65(1) was still applicable and determined that an entity had to submit its financials to Parliament. It did not give the leeway of not tabling at all because SAA had provided explanations. At the previous meeting, the board had said that it could not present the financials because it could not guarantee the company as a going concern and there had been an undertaking from the shareholder to provide R2 billion and that when the R2 billion funding had been received, the financials would be provided. Funding had been received but the financials had not been provided. Section 65(2) did not give the entity leeway to ignore section 65(1) and pretend as if it did not exist. When was SAA planning to submit the financials? Without the financials, Members could not understand the extent and nature to which intervention was needed.

The Chairperson stated that the financials remained an outstanding matter. He noted that the Minister had said that they were in unchartered waters. The last time that SAA had appeared before the Committee, Members had been informed that the basis not to provide the financials was informed by a legal opinion. The Committee had requested to see that legal opinion. The Committee had consulted parliamentary legal services and so, to understand the situation better, the Committee wanted to see the legal opinion. That had not been seen. Members had had very little joy in respect of receiving information from SAA. Promises had been made but deadlines had not been met.

Mr Hadebe asked if SAA understood that 65(2) compliance meant that they did not have to comply with 65(1) ever. Two consecutive financials had not been submitted.

**Responses by SAA**

The Minister explained that that was the dilemma of going into business rescue.
Mr Makobe said that section 65(1) was the obligation and 65(2) provided the opportunity to give reasons for not complying. It did not give the option of not complying with section 65(1) but it gave an organisation the opportunity to address the going concern issues so that it could comply with section 65(1). It was not business as usual. Business rescue practitioners (BRP) were developing a plan to show that SAA could be rescued. Once the BRPs had finalized the plan and it was implemented, the financials could be supplied. The BPR had to address the creditors and say that the business could be rescued and that had to be voted upon by the creditors. Once that had been done, SAA would be on a good footing and the AFS could be supplied.

The Chairperson cut him short. The Committee was not prepared to discuss whether it should get the financials. He wanted to leave the previous agreement that SAA would supply financials on the table. The Committee had noted the circumstances that Mr Makobe had outlined but one did not submit financials on the basis of a going concern, one submitted on the basis of compliance. There would not be a discussion: SAA had not complied and the Committee required a plan or a roadmap for submitting the AFS. The financials should tell the story as it existed, going concern or not. As the Committee had said, SAA had exhausted its leeway and he was leaving the agreement as it stood.

**Response by the Minister of Public Enterprises**

The Minister stated that he would take proper legal advice so that everyone understood the position of SAA and section 65. The reality was that the business had been facing liquidation and completing the financial statements would have meant that liquidation would have happened immediately, planes would have been grounded and the business would have closed, jobs would have been lost and creditors would line up. The board had endeavoured to avoid that scenario. He respectfully suggested that it was not about compliance or non-compliance but about the reality of managing failing SOEs and ensuring that the state saved whatever it could, saved as many jobs as it could and realised as many assets as it could. He would get a legal opinion, especially on section 65 versus the Companies Act. However, he would also see if he could get some financial statements so that Members could see what was going on, but without giving any financial accounts. He needed a week or two to get some insight into the possibilities.

The Minister informed Mr Lees that he was not aware of a decision to liquidate SAA. All guarantees were determined by the National Treasury and the Minister of Finance and he would present details in the Budget Speech on 26 February 2020. Members would see what National Treasury’s intentions were in the Budget Speech.

Why did SAA need PCF? The Minister explained that a business in business rescue continued as it was and it needed PCF to feed the company, pay workers, etc. All guarantees were supplied by the fiscus. He was aware that a Gupta mine had gone into business rescue without a PCF and workers had not been paid. The PCF allowed the business to continue as usual until it was restructured.

The Minister informed Ms Mente that finance was required to keep the business going. In November 2019, there had been a two-week strike and one union had stated that it was not safe to fly SAA. Ticket insurance was immediately withdrawn in the US and that had resulted in an 85% drop in ticket sales. 65% of SAA’s booking were for foreign/international flights. In late November two SA ticket insurers had withdrawn insurance but in the past week, the business rescue practitioners had persuaded the two insurers to insure SAA tickets once more. If a ticket was not insured, the passenger was taking all the risk for delayed flights, etc. and passengers were reluctant to take that risk. Ticket insurance was critical to get an airline working. Withdrawing that provision had forced a decline in SAA. Thirdly, certain travel agents, such as Flight Centre, had refused to book any passengers on SAA flights but, following a meeting with the Association of SA Travel Agents, that position had changed. They were now supporting bookings on SAA. Confidence in an airline was critical. The Minister suggested that if all Members of Parliament travelled on SAA, it would make a difference and if all government officials travelled SAA that would really increase revenue. Perhaps the Chairperson could push that position. He noted that opposition parties tended to travel on different airlines.

The business rescue practitioners had to constantly match the question of costs versus revenue. Between National Treasury and SAA, they were doing the best they could to provide PCF. He asked Ms Mente-Nqweniso for the name of the company that she had referred to and any other information that would enable the business practitioners to commence saving money.

There had been endless reports and turnaround plans but the big problem was the inability of the state to implement the plans and if those plans were not implemented, the entity reached the position of SAA. The board had good intentions but did not have the capability of doing what had to be done.

The Minister informed Adv Swarts that an aviation firm had been employed to advise the business rescue practitioners who were also looking at the previous recommendations of aviation companies. The sale of aircraft referred to the A340 which preceded the rescue process because it was about technical issues and how expensive those aircraft were to fly.

As far as lessons about the PFMA and Companies Act were concerned, the Minister stated that he

---

https://pmg.org.za/committee-meeting/29827/ 19/06/2020
still digesting that but if a business rescue practitioners became the accounting authority and they were accountable to the Executive Authority in the first instance in terms of the PFMA and ther once the plan had been published, the Executive Authority became accountable to the structures as per the Constitution.

Mr Lees said that Members had not received full responses to their questions.

The Minister stated that there was a bigger pool of debt and that would be addressed in the Budget. The money borrowed from the SA Development Bank would last until early March 2020 and had to be repaid by SAA by about mid-year. Those were moving parts and every day it was necessary to adjust matters and to save as many jobs as possible.

Mr Cachalia stated that he had asked, beyond the headlines news, for the rationale that had led to the choice of business rescue, given that there had been an extension for the development of the plan.

The Minister replied that restructuring, as in the business rescue process, had been responded to: liquidation was not the best option for all stakeholders as it had several catastrophes, there was something to be rescued, and the business rescue practitioners saw something of value in SAA.

Ms Mente noted that there was a shortfall of R2 billion in 2016 and now the shortfall was R4 billion. What informed that increase?

The Chairperson explained that in the last Annual Financial Statement, the revenue was about R31 billion and expenditure was at R33 billion. SAA had provided that figure to the Fifth Parliament.

The Minister referred to the graph in his presentation and said if an entity keeps making losses, revenue declined and costs increased. The strike, the withdrawal of insurance and loss of sales had led the debt to grow. A couple of years ago, the strategy had been to shrink to grow and so the number of flights had been reduced. The frequency of flights was cut by the management to save and grow but if a company kept shrinking, one ended up with increased losses.

The Chairperson noted that there was no SAA flight from Durban to Cape Town so he could not fly SAA.

The Minister stated that it depended how many people he brought onto the flight.

The Chairperson asked that all questions be pointed and succinct.

Further discussion

Mr S Somyo (ANC) was guided by the presentation made that was based on the Companies Act. When the Minister’s team applied on the basis of section 150 that the business rescue practitioner sought to develop a plan that had to be published. His basic interest was in seeing an institution that met the requirements of its own existence. The board had proposed a way forward and now there was the appointment of business rescue practitioners. The Committee had been given some kind of a view of what was pertaining at that stage. The Members’ questions were not serving the purpose of specificity and that specificity would only come with the report. He asked the Minister to provide timelines for the report and then the meeting should be closed.

The Chairperson noted the proposal but was not going to present it at that time.

Mr E Buthelezi (IFP) took the avoidance of catastrophe as the reason for going the route of business rescue practitioners. The Minister had referred to plans that had not worked as a result of the state’s lack of capability to implement the plans. How was the Minister convinced that after all had been done that the state could implement the plans?

Ms B Swarts (ANC) asked for timeframes for the business rescue practitioner process. After three months, there would be monthly reports from the business rescue practitioners. Was the date counted from 16 December or was it from the date that the team began working? The board and SAA had told the Committee of losses emanating from Airlink. What percentage of SA Airlink did SAA own? SAA handled infrastructure for Airlink and did bookings and servicing of planes “free” in exchange for the two percent “franchise fee”. She wanted to know if there were any dividends from the servicing of SA Airlink. Did SAA service Airlink planes free of charge. What did the 28-year package deal entail? She asked for an analysis of SA Express which was a failing entity but it competed with Airlink. What was the link? It seemed that SAA did a lot of babysitting of SA Airlink. What were the pilot salaries and their family benefits? Why could the state not rationalise the three airlines of SAA, Mango and Airlink?

Ms T Marawu (ATM) appreciated the presentations by the Acting DDG and the Minister. She asked about the turnaround plan of the board. There were critical points in that plan that would be helpful – would those be incorporated or would there be a new plan? Secondly, what about timeframes? Thirdly, were the skills available to implement the plan? Was a skills audit taking place so that one knew if there were skilled people available who could implement the plan?
Ms C Phiri (ANC) wanted confirmation of why it had been deliberately decided not to go for liquidation. She had understood that the AFS had not been submitted because that would lead to liquidation. She wanted a confirmation even though her colleagues had already asked the question because the people of South Africa had to understand that point about section 65. She also asked when the plan would be presented. From what date were the three months of business rescue counted?

Ms B van Minnen (DA) noted that the Minister was concerned about failing state-owned enterprises (SoEs). SoEs were being bailed out with taxpayers’ money, resulting in devastating cuts to departmental budgets. She understood the concern about employees, but were the SoEs not just grandiose welfare institutions? Would the economy not be better served by allowing private business to take over and run the companies according to the needs in the market?

Ms van Minnen asked why the opportunities to sell SAA over the past couple of years had not been taken up. With SAA actively admitting that they could not provide the AFS, was that potentially disadvantaging creditors?

Mr N Mwankwa (UDM) asked if section 65 was not open to abuse as it was open-ended. Parliament needed to address the loophole in section 65(2) or more entities would use that loophole and there would be nothing Parliament could do. He suggested to the Minister that when entities could not provide the AFS, they should provide other financial information. Members could not understand the scale of the problem without any financial information. The Minister had briefed the Committee about the decision taken in December. He simply had to give the date for the business rescue plan and then the meeting would be over because there was nothing further to discuss. The Minister had to give a commitment about giving some financial information or Members could not ask questions.

Ms J Tshabalala (ANC) said that it was a necessary trauma to save the national carrier. She asked the Minister about the routes and the provision of licenses for other airlines to use the routes. Perhaps those licences should be suspended so that SAA could service those routes. She expected that nothing would happen outside of the Labour Law but what was to be done about Labour? When would the management team be assembled to implement the plan? The ANC was very clear that it wanted to retain SAA as a national carrier. Which airline was it that was interested in entering into a strategic equity and management partnership with SAA?

Ms O Maotwe (EFF) said that Members had come excited and the nation wanted to know how the funds were being managed. However, when the Minister still has to consult lawyers about releasing the financial statements, then it was a different animal. If he was a personal shareholder in a company that did not produce an AFS, surely he would have shot all the management and executives? SAA was a national asset and the nation "out there" wanted to know what was happening. The Minister had an entity and he was getting money so she wanted to know how he was managing those funds. It ended there. When was Parliament getting the AFS? The Minister could not give excuses like legal opinions. She was not interested. The Minister had to give the answers – it remained his responsibility. Regarding the issues of funding, what was it that was going to be done differently to turn SAA around if funding was provided? SAA was being run into the ground. Members had the powers to remove the Minister and she suggested that if the AFS was not provided, the Minister and all those involved would be removed.

She asked how a flight on the extremely busy route from Johannesburg to Durban could be cancelled but the flight from Johannesburg to Nelspruit was retained. What was going on? There were other intentions there.

Lastly, she asked what the intention was regarding labour. Labour was a very important stakeholder and Labour was taking SAA to court as the airliner was cancelling routes and would dismiss workers. The workers in Durban had been told not to return to work in March but there had been no consultation with labour in that regard.

The Chairperson said that it had been agreed that Parliament wanted the statements. That was non-negotiable. The Minister spoke of getting legal advice but SAA already had an opinion from a lawyer. SCOPA had asked to see the legal opinion but had not been given a copy. Nevertheless, an opinion remained precisely that, an opinion. The law, in section 65(2) of the PFMA stated that reasons could be given for not submitting an AFS, but those reasons did not have to be accepted by Parliament.

SCOPA had an agreement with SAA that a plan would be made to supply the Annual Financial Statement (AFS). That agreement was not being retracted.

Response by the Minister of Public Enterprises

The Minister informed Mr Somoyi that three months took one into early March. The business rescue practitioners had to present a plan by that time and as soon as the plan had been accepted by creditors, the plan would be presented to one or both of the Committees as they determined. New expertise would be brought into the airline and SAA would use existing expertise to develop a team that was able to run an airline. Not everyone had the skills to run an airline. The SAA/government held a 2.67% stake in SA Airlink.

Pilots’ salaries and benefits were regulated by an evergreen agreement negotiated in the 1990’s. The agreement had gotten SAA into extreme difficulties. The board had decided on a court action to review the status of that agreement. The Pilot Union was one of the seven unions recognised at SAA and they were all talking to business rescue practitioners. SA
Express was also in business rescue as one of its creditors had approached the court and there might be some difficulties as a result of that process. Mango, Air Chefs, SAA Technical and SAA were all subsidiaries or components of the SAA Group. The future of all entities had to be decided as the process unfolded. There was chaos in SAA Technical. Ten years ago, SAA Technical had been a leading technical division in the world and certainly the best in Africa, but it had been decimated by capture and corruption but there was a rebuilding process there under the previous CEO and now it was being run by new CEO from New Zealand who was trying to patch things together. There was huge amount of value in SAA Technical that needed to be saved.

The Minister assured Members that all previous business models would be reviewed and those that were relevant would be taken onboard. That had happened in the case of Eskom. He told Ms van Minnen that SoEs were definitely not welfare institutions. As the President had said, government wanted state-owned entities that had a commercial mandate, where that was applicable, and a service delivery mandate, where that was applicable. Secondly, SoEs had to be financially self-sufficient, unless the state needed to subsidise services, especially to the many poor people in the country. Thirdly, SoEs would have to review their business models. Eskom was an example where the business model had been reviewed and arising from that was the Eskom Roadmap Paper and arising from that was the restructuring. That would apply to other entities that might have been applying a business model for more than ten years. Unfortunately, that did not make it applicable to doing business in the future. Some services, e.g., freight and port services, were important to the cost of doing business in SA, and especially the administrative pricing. The entities had to be established and pay for themselves. It was not about being welfare schemes because they had to be clear about their roles and responsibilities and be able to deliver on those.

A key weakness seen in SoEs was operational inefficiency and that, with corruption, had decimated entities. The Eskom inquiry had shown how deep the damage was to the entities. Members should read the report of that enquiry. The damage was not going to be repaired overnight; it was going to take a long time. The Administrator of PRASA had said exactly the same thing on television the previous day. A new board or executive would not automatically change things. It could not change operations. There was tough work ahead. The attitude and culture in an entity had to change. The relationship of revenue to costs was vital.

The Minister stressed that, ultimately, it was about money, as SCOPA well knew. Where there was a possibility of sustainability that had to be the demand placed on the board. Neither the private sector nor the state was the panacea. One had to get the right combination. Ms Tshabalala had asked who would be chosen as equity partner and others had spoken of selling SAA. SAA could possibly be sold for R1 but one would more likely have to pay people to take SAA. The business rescue practitioners had to turn SAA into a viable business before anyone would even look at the business. No one wanted a loss-making business.

The Minister stated that Mr Kwanza had made an important point about section 65(2). However, he assured the Members that there was no deliberate intention not to supply the AIDS on the part of SAA. The impediment had been the possibility of liquidation if those accounts had been prepared. He thought that making the SAA management accounts available might assist SCOPA. He would get a legal view and the business rescue practitioners' views on that matter.

He said that routes for SAA were all up in the air. At the moment all routes were unprofitable because SAA was paying leasing costs on aircraft and the excessive head office costs were linked to routes. An analysis of the situation at head office was underway and one could then see what could be done about it.

The Minister assured Members that before business rescue, there had been interactions with Labour and the business rescue practitioners were still engaging with Labour. He pointed out to certain Members that the law did matter because that was the law. One could not disregard the law.

The Minister stressed very strongly that there was no intent by he or the present management to run the company down. There were others who were attempting to do that and they should be identified and dealt with more quickly than they were being dealt with.

The Minister admitted that an error had occurred in Durban. A manager had misread or misunderstood a note from the BRPs and had provided incorrect information but that person had withdrawn the statement the very next day as it had been brought to the person's attention that the statement was incorrect. He had a report from the person involved declaring the withdrawal of the statement. The court case had nothing to do with that incident and the court had decided in favour of SAA.

The Minister agreed that he would inform the Committees as soon as the business rescue practice report was ready and he would make a presentation to the Committees.

The Acting DG informed the Committee that Airlink had its own maintenance services in-house and did not rely on SAA for the servicing of its aircraft.
Mr Lees said that the business rescue practitioners had to answer the questions, not the Minister. Mr Cachalia's question was not about the decision to put the company into business rescue. That question had been thoroughly answered. Only the business rescue practitioners could say why they had decided within the first ten days that the business was rescuable. Their role was to see if the business could trade its way out of debt. He presumed that financial commitments were made about PCF. He asked that the business rescue practitioners answer the question as it was a key question.

Mr Hadebe said that everyone was alive to the possibilities and realities that were happening in SAA but SCOPA had been patient for two years. After two years, SAA had to gravitate towards normality and compliance. Parliament did not want to see SAA go into liquidation and create massive job losses. That would be met with the hostility it deserved. The Committee derived its authority from parliamentary rule 245 and so all entities had to provide financials. The business rescue practitioners had to understand that and had to supply the date for submitting the AFS. The business rescue practitioners had to account from the point that they had taken over on 6 December when they had become the Accounting Authority according to section 49 of the PFMA. He would have loved to hear the voices and the views of the business rescue practitioners.

Ms Mente said that there were questions that the Minister could not answer, only the Administrators. She presumed that the board was still there but was taking direction from the BRP. Kintetsu World Express (KWE) was the company that she had referred to earlier. It was situated in the hangar next to SAA Technical. SAA had paid R267 million to that company to invoice SAA technicians for their own stock. In the board turnaround plan, that contract and others were to be cancelled to eliminate the excess in expenditure. Which contracts had been cancelled? Pilots' benefits were outrageous. Had those issues been addressed? SAA had to obey the law and submit its financial statements. SA could not be a lawless country.

The Chairperson said his frustration was the Members' frustration. He wanted to find a way of arriving at where SCOPA wanted to go. He did not want to conduct a hearing in a vacuum. A hearing would be conducted. He wanted the AFS, and if SCOPA had to go to SAA with "boots on the ground" to obtain financial details, SCOPA would do so. SCOPA did not sanitise facts. If the right things had been done at SAA, the current situation would not exist.

He suggested that the meeting be suspended, not closed. All was not well in the state of SAA and the Members had reason to be concerned. He requested answers to the questions and then he and the co-Chair would consult. The purpose of the meeting was to ensure that it was understood by SAA, the ministry and the business rescue practitioners that all their work would take place within the parameters of the oversight of the Committee.

The Chairperson stated that he was exercising dictatorial tendencies and suppressing Members' requests to speak.

Response by Minister
The Minister appealed for patience. It was unfair to place business rescue practitioners in a position where they could only provide fragmented answers. The Members needed a full response and he guaranteed that that would happen. Decisions still had to be made regarding routes and other issues. He took the point about liquidations and the point about the PFMA and the fact that the Companies Act did not specify SoEs. He would follow up on the company mentioned by Ms Mente. She was correct in that certain contracts had to be looked into and, where necessary, the contracts cancelled to save costs.

Closing Remarks
The Chairperson maintained that the Committees needed to hear from the business rescue practitioners. Their work had to be concluded by 6 March 2020 and a date would be set for the business rescue practitioners, who formed the Accounting Authority, to appear for a full hearing. SAA could not venture into any new arrangement without SCOPA hearing from the business rescue practitioners who were responsible for the transitional period. In the legacy report matters had been raised, those matters and futuristic matters. However, SCOPA would not deal with policies – that was the business of the Portfolio Committee on Public Enterprises.

SCOPA would map out the way forward. The matter had not ended. SAA remained at the centre of parliamentary focus.

The meeting was adjourned.
<table>
<thead>
<tr>
<th>Date</th>
<th>Key Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007/08</td>
<td>Labour Restudcuing: Support to Restore going concern</td>
</tr>
<tr>
<td>2006/07</td>
<td>Conversion of loan to debenture via Transient following Repudiation via FA34</td>
</tr>
<tr>
<td>2005/04</td>
<td>Transient losses following repudiation via FA34 (R million)</td>
</tr>
<tr>
<td>2003/04</td>
<td>Total used to cover losses (R million)</td>
</tr>
<tr>
<td>2002/07</td>
<td>Maintenance concern going (R million)</td>
</tr>
<tr>
<td>2001/07</td>
<td>To cover losses (R million)</td>
</tr>
<tr>
<td>2000/07</td>
<td>Maintenance concern going (R million)</td>
</tr>
<tr>
<td>1999/07</td>
<td>Maintenance concern going (K million)</td>
</tr>
<tr>
<td>1998/07</td>
<td>Maintenance concern going (K million)</td>
</tr>
<tr>
<td>1997/07</td>
<td>Maintenance concern going (K million)</td>
</tr>
<tr>
<td>1996/07</td>
<td>Maintenance concern going (K million)</td>
</tr>
<tr>
<td>1995/07</td>
<td>Maintenance concern going (K million)</td>
</tr>
</tbody>
</table>

**Table:**

<table>
<thead>
<tr>
<th>Date</th>
<th>Key Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009/10</td>
<td>Conversion of B747-400s</td>
</tr>
<tr>
<td>2007/08</td>
<td>Voluntary Restudcuing: VAT on R744m</td>
</tr>
<tr>
<td>2006/07</td>
<td>Labour Restudcuing: None used as Peninsula - fenced (1.300)</td>
</tr>
<tr>
<td>2005/04</td>
<td>Recoupling (K million)</td>
</tr>
<tr>
<td>1999/07</td>
<td>How much spent on portfolio (R million)</td>
</tr>
<tr>
<td>1998/07</td>
<td>How much spent on portfolio (R million)</td>
</tr>
<tr>
<td>1997/07</td>
<td>How much spent on portfolio (R million)</td>
</tr>
<tr>
<td>1996/07</td>
<td>How much spent on portfolio (R million)</td>
</tr>
<tr>
<td>1995/07</td>
<td>How much spent on portfolio (R million)</td>
</tr>
<tr>
<td>1994/07</td>
<td>How much spent on portfolio (R million)</td>
</tr>
<tr>
<td>1993/07</td>
<td>How much spent on portfolio (R million)</td>
</tr>
<tr>
<td>1992/07</td>
<td>How much spent on portfolio (R million)</td>
</tr>
</tbody>
</table>

**Notes:**

- Conversion of B747-400s: 2009/10
- Voluntary Restudcuing: VAT on R744m: 2007/08
- Labour Restudcuing: None used as Peninsula - fenced (1.300): 2006/07
- Recoupling (K million): 2005/04
- How much spent on portfolio (R million): 1999/07 to 1992/07

**Details:**

- FA34: 767
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Working Capital</td>
<td>2,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>18,243</td>
</tr>
<tr>
<td>Financed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exit Bridging</td>
<td>3,500</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working Capital</td>
<td>2,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guaranteed</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All used</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guaranteed</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All used</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concern</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance going</td>
<td>4.4/20</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concern</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance going</td>
<td>4.4/20</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concern</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance going</td>
<td>4.4/20</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concern</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance going</td>
<td>4.4/20</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concern</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquidity</td>
<td>0.06</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guarantee</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance going</td>
<td>388</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concern</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Need for equity</td>
<td>1,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance going</td>
<td>388</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concern</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance going</td>
<td>388</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concern</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subordinated loan to</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Assessment of SAA’s Business Rescue Plan

An independent report prepared on behalf of SA Airlink

20 June 2020
Document Reference: SAA Business Rescue Plan Assessment
Date: 20 June 2020

Contact Information

Genesis Analytics (Pty) Ltd

Physical 50 Sixth Road, Hyde Park, Johannesburg
Postal PO Box 413431, Craighall, 2024, South Africa
Telephone +2711 994 7000
Facsimile +2786 688 2247
Registration No. 1998/001950/07

www.genesis-analytics.com

Authors

Anthony Felet and Donnavan-John Linley

Contact Person

Anthony Felet
anthonyf@genesis-analytics.com
Table of Contents

1. INTRODUCTION .................................................................................. 1

2. ASSESSMENT OF THE BRP ................................................................. 2
   2.1. Principal concerns ........................................................................ 2
   2.2. Lack of Rationale for the proposed restructure ......................... 4
   2.3. Lack of disclosure of underlying data and assumptions ............. 5
   2.4. Plausibility of revenue and cost estimates ..................................... 6
   2.5. Economic value of projected financial outcomes ....................... 8
   2.6. Implications for South African airline market ............................ 9

3. CONCLUSION ..................................................................................... 10

APPENDIX: BRP FINANCIAL PROJECTIONS ........................................... 11

List of Figures
Figure 1: SAA Fuel costs % SAA revenue ............................................. 7

List of Tables
Table 1: Risk factors associated with the proposed BRP ...................... 8
1. INTRODUCTION

1. Genesis Analytics has been commissioned by SA Airlink Ltd to independently assess the South African Airways ("SAA") Business Rescue Plan ("BRP") prepared by the business rescue practitioners Siviwe Dongwana and Leslie Matuson. Specifically, we have been asked to assess the merits of the plan and the long-term prospects of its success. To this end, we have sought to answer the following questions:

1.1. Does the BRP adequately explain the rationale of the proposed restructuring of SAA and it will produce the projected financial outcomes?

1.2. Is the proposed restructuring rational given the underlying causes of SAA's financial distress?

1.3. Are the revenue and cost assumptions contained in Annexures C and D of the BRP plausible given SAA's historical financial performance?

1.4. Do the financial outcomes projected in the BRP generate economic value to government and taxpayers?

1.5. What are the implications of the plan to the South African airline market generally?

2. Prior to assessing the BRP, we reviewed the draft BRP as circulated to the Creditors Committee for comment on 29 May 2020 ("Draft BRP"). We also reviewed documents that provided relevant historical context to SAA's financial performance, including SAA's Integrated Report for the year ended 31 March 2017, the Group Annual Financial Statements for the year ended 31 March 2018 and the draft Group Annual Financial Statements for the year ended 31 March 2019. These documents were used primarily to test the plausibility of the BRP's revenue and cost assumptions, which are major variables to the projected financial outcomes. Our analysis was based on the limited financial information contained in the BRP as no underlying calculations of the projected SAA profits were provided.

3. Section 2 contains our assessment of the BRP and provides our response to each of the questions listed above. Section 4 contains our summary conclusions of the BRP. The Appendix contains the projections of SAA revenues and costs (as disclosed in the BRP), which we refer to in our assessment.

4. The authors of this report are Anthony Felet and Donnavan-John Linley. Anthony is a leading expert in the field of investigative financial analysis and accounting. He has worked on behalf of the South African Competition Commission in cases involving allegations of excessive pricing, predatory pricing and margin squeeze. Donnavan-John is an independent consultant that specialises in industrial economics. He spent five years at the Competition Commission and his responsibilities included investigating mergers and enforcement (abuse of dominance) cases, engaging with stakeholders, gathering information and data, and preparing reports for decision makers.

---

2. **ASSESSMENT OF THE BRP**

5. In this section we outline our principal concerns regarding the BRP before describing its specific shortcomings, including the lack of rationality of the proposed SAA restructuring, the implausibility of the revenue and cost assumptions, the economic losses that will be incurred under the BRP and the likely impact of SAA business rescue on the South African airline market.

2.1. **PRINCIPAL CONCERNS**

6. In assessing the merits of the BRP, it is important to consider the historical performance of SAA and the causes of its financial distress. The BRP confirms that SAA was in dire financial distress prior to the commencement of Business Rescue and attributes this outcome to years of accumulated losses, poor governance, inadequate recapitalisation and increased competition. The last two stated causes lack merit as other airlines operating in the South African market, including Airlink and Comair, were able to operate profitably on a consistent basis (at least up to the COVID-19 lock-down) with significantly lower levels of capitalisation and exposure to the same competitive forces. In this regard, the BRP fails to properly identify the true causes of SAA’s failure.

7. SAA’s insolvency has arisen from cumulative reported losses incurred since FY2012, which have totaled R27.2 billion\(^2\) at an average of R3.4 billion per annum. Total accumulated losses as at FY2019 were R41.5 billion.\(^3\) SAA’s losses were R5.3 billion, R5.5 billion and R5.0 billion in FY2017, FY2018 and FY2019 respectively\(^4\). More losses are expected for FY2020, caused largely by technical issues, strike action, cancelation of flights and negative consumer sentiment following the announcement of the Business Rescue\(^5\).

8. Given these losses, SAA has required government financial support for a number of years. This has been provided in the form of shareholder contributions and government guarantees. In the last three financial years, government has contributed more than R20.5 billion in financial support\(^6\). A further R16.4 billion has been allocated to repay secured debt and accrued interest\(^7\). These interventions have put immense fiscal pressure on government.

9. The lack of corporate governance at SAA has been well documented. In addition to poor decision making, this has resulted in high executive management churn over the past 10 years\(^8\). During this period, SAA has had eight CEOs, four CFOs and 50 Exco members. This unstable governance, combined with consistent operating losses has undermined SAA’s ability to continue as a going concern. Given the historical impact of these corporate governance failures, it is unfortunate that the BRP does not address this aspect in its restructuring plans, or list this as one of the key potential risk factors that could undermine the success of the BRP.

---

\(^2\) This value is calculated by subtracting accumulated losses as per the Statement of Financial Position of SAA’s 2011 AFS from accumulated losses as per SAA’s 2019 AFS.

\(^3\) Balance Sheet information on p.2 of SAA’s Draft 2019 AFS.

\(^4\) Statement of Profit and Loss on p.1 of SAA’s Draft 2019 AFS.

\(^5\) Draft BRP, para 5.3. Annexure A.

\(^6\) Statement on SAA by Minister of Department of Public Enterprises: 19 November 2019.

\(^7\) BRP, para 30.3.

\(^8\) Draft BRP, para 5.3.1.2.6. It has been through 8 CEOs, 4 CFOs and 50 Exco members in the past 10 years who, see BRP (para 12.3.1.2.6.3).
10. The BRP has come at a time when the global aviation industry has suffered its worst conditions due to the Covid-19 pandemic. The devastating impacts of the pandemic on the South African airline industry is acknowledged in the BRP, along with risks this poses for achieving the BRP financial projections.9

11. The BRP contains restructuring proposals for SAA that involves maintaining the current SAA Group and making only modest modifications to the scale of operations that existed prior to the Commencement Date (05 December 2019). This includes:

11.1. Reducing the number of routes from 32 to 26.\textsuperscript{10}

11.2. Reducing the number of aircraft fleet from 44 to 6 (for the period June – Aug 2020), and then increasing to 23 aircraft by September 2020 and then to 26 aircraft by January 2021.\textsuperscript{11}

11.3. Reducing the number of employees from 4708 to approximately 1000, with revised terms and conditions.\textsuperscript{12}

12. The BRP also outlines the proposed arrangements with Affected Persons:

12.1. Concurrent creditors will receive R600 million (7.5 cents in the Rand) for final settlement of amounts owing, paid over three years.\textsuperscript{13}

12.2. Lessors will receive R1.7 billion (6 months rental payments) paid over three years.\textsuperscript{14}

12.3. Lenders guaranteed by government will receive R16.4 billion, which will be paid for by government allocations.\textsuperscript{15}

13. The BRP states that above proposals will require R10.3 billion of government funding for a working capital injection (R2.8 billion), retrenchment costs (R2.2 billion), unflown ticket liability (R3 billion), payments to Concurrent Creditors (R600 million) and payments to Lessors (R1.7 billion).\textsuperscript{16} We understand that this funding will not be required in the event of SAA being liquidated, and therefore represents the incremental financial commitments arising from implementing the proposals as contained in the BRP. A BRP requiring this magnitude of funding requires a robust financial feasibility assessment that quantifies the expected returns to government and taxpayers. This crucial aspect is wholly absent in the BRP.

14. Another major issue with the BRP is that the projections differ markedly to the projections contained in the draft BRP. For example, the Draft BRP projected SAA revenues to be R20.9 billion for the first year following business rescue\textsuperscript{17}, whereas the BRP projects SAA revenues to be only R2.2 billion for the same year. There are also significant differences in the cost assumptions. For example, fuel costs were expected to account for 25% of total revenues in the Draft BRP but only 14% in the BRP. These unexplained differences

---

\textsuperscript{9} BRP, pages 66, 86 and 101.
\textsuperscript{10-11} Paragraph 12.1.3.1 of the BRP states there were 30 routes, however, the table titled "Proposed Routes" on pages 16 and 83 contains a list of 32 routes as at Business Rescue date. These tables show a closure of 6 routes.
\textsuperscript{12} BRP, page 17.
\textsuperscript{13} BRP, pages 18 and 25.
\textsuperscript{14} BRP, page 17.
\textsuperscript{15} BRP, page 18.
\textsuperscript{16} BRP, page 89.
\textsuperscript{17} BRP, pages 84 and 85.
\textsuperscript{17} Draft BRP Annexure D.
undermine the credibility of the BRP revenue and costs projections and significantly reduce the likelihood of the business rescue process achieving the desired outcome, namely SAA continuing in existence on a solvent basis.18

15. The BRP does not consider the significant economic losses suffered by creditors (and the wider airline industry) from SAA’s insolvent trading over the past decade.19 Annexure B of the BRP discloses R38.4 billion worth of Concurrent Creditor claims against SAA, of which only R2.3 billion will be settled under the plan. This represents a 94% loss for Concurrent Creditors. It is crucial that any restructuring plan prevents any further losses arising from SAA trading under insolvent circumstances. As we explain below, the BRP as it stands provides no reassurance that SAA will trade profitability in the short to medium term. The lack of short-term profitability, as predicted in the plan, will inevitably expose SAA creditors to further economic losses.

2.2. LACK OF RATIONALE FOR THE PROPOSED RESTRUCTURE

16. The BRP states that only eight SAA routes (out of 32) were profitable during the 2019 calendar year: one international and seven regional routes. No domestic routes were profitable20. The BRP also states that 11 routes were *significantly loss making* with limited prospects of success, including:

16.1. Three international routes (Hong Kong, Munich and San Paulo)

16.2. Four regional routes (Luanda, Entebbe, Dakar and Abidjan)

16.3. All four domestic destinations (Cape Town, Durban, Port Elizabeth and East London)21

17. The BRP provides a list of routes to be maintained and cancelled post restructuring. It proposes that 27 routes should be maintained (mostly regional routes) and only six routes (four international, one regional and one domestic) be cancelled. This means that the BRP proposes to cancel 20% of SAA’s routes despite 75% of routes being loss-making. Further, of the above 11 routes which are significantly loss-making with limited prospects of ever being profitable, the BRP proposes to maintain six of them. No explanation is provided on the operational measures that would be taken to improve the financial performance of these routes. In fact, the BRP projects the load factors to be significantly lower than the historical load factors achieved on SAA flights, which suggests that losses on these routes are likely to increases.22 Accordingly, there is no rationale for keeping the bulk of the SAA route network as proposed in the BRP.

18. Although the BRP anticipates significant staff redundancies that may reduce costs on routes, this assumes that government will be willing and able to fund these redundancies, which is anticipated to cost R2.2 billion. Surprisingly, the BRP predicts that staff levels will increase from 1200 to 2900 by FY2024, which undermines the expected cost savings expected from the redundancy program. To the extent that SAA is able to reduce staff levels significantly on certain loss-making routes, this is likely to have adverse impacts on

---

18 BRP, page 76 – see Objective A
19 Section 22 of the Companies Act, 2008, states that a company must not carry on its business recklessly: with gross negligence, with intent to defraud or trade under insolvent circumstances.
20 BRP, page 60.
21 BRP, page 61.
22 Annexure D of the BRP predict load factors to reach a maximum of 64% by FY2025 whereas SAA historically achieved load factors of approximately 75% according to SAA 2017 AFS (page 96).
service levels and load factors, and subsequently undermine SAA’s ability to make these routes profitable.

2.3. LACK OF DISCLOSURE OF UNDERLYING DATA AND ASSUMPTIONS

19. The financial projections contained in Annexure C of the BRP provides limited information on revenue and cost assumptions, which makes it impossible to understand how projected revenues and costs were derived by the business rescue practitioners. Although some operational metrics are provided (number of passengers, flights, aircraft load factors and headcount), these are significantly less than the scope of operational metrics contained in the Draft BRP, which included passenger kms, available seat kms and average revenue per pax. The absence of these metrics in the BRP is contrary to the requirements in Section 150 (3)(a) of the Companies Act, which states that the financial projections prepared by the business rescue practitioners must include disclosure of any material assumptions on which the projections are based.

20. A business of the complexity and scale of SAA should include, at a minimum, the disclosure of the following operating assumptions to make the BRP projections credible:

20.1. Exchange rate movements (ZAR:USD), which a key variable for lease and fuel costs.

20.2. Fuel prices expressed in USD

20.3. Available seat kms for each route

20.4. Revenue per available seat kms for each route

20.5. Cost per available seat kms for each route

20.6. Staffing levels (pilots, cabin crew etc.) for each route

20.7. Load factors for each route

21. The BRP must disclose how the revenue and cost projections are driven by the projected performance of individual routes. Specifically, projections of profitability for the 26 routes that are to be retained for the five-year period ended FY2025 needs to be part of the BRP. Without this disclosure, it is not possible to assess the merits of retaining each of the planned routes or the assumptions used to measure their financial viability. The BRP should be supplemented with a spreadsheet file that contains all the revenue and costs assumptions, the timing of the introduction of individual routes and the calculations for the consolidated projections shown in Annexure C.

22. Given the absence the revenue and costs projections on individual routes, it is likely that the Annexure C projections were calculated on an aggregated company-wide basis. Each of the routes will have different profiles in terms of the timing of reintroduction, passenger yields and costs per seat kms. Accordingly, projecting revenue and costs on an aggregated basis, which appears to be the approach used in the BRP, is irrational and uninformative.

---

23 PART C of the BRP titled “Assumptions and Conditions” (page 104) contain no such assumptions. Paragraph 41.3 states that certain assumptions were made but only definitions of certain revenue and cost items are provided.
23. The BRP does not reconcile the reported share capital of R33.6 billion in FY2020\textsuperscript{24} to the projected share capital of R53.9 billion in FY2021\textsuperscript{25}. This reconciliation is important as the BRP claims to restore SAA to technical solvency, but it is not clear how this will be achieved. For example, the R16.4 billion payment to secured lenders is not included in the cash flow statement, which implies that the banks are paid directly by government. The BRP does not explain how share capital will increase from R53.9 billion in FY2021 to R61.5 billion in FY2023. The projected movement in share capital from FY2020 implies that government funding will total R28 billion. This is a significant fiscal commitment for a restructuring plan that has no reasonable prospects of success. The projections in Annexure C show that SAA will continue to be significantly loss-making for the next three years, which is likely to cause insolvency in future.

2.4. PLAUDIBILITY OF REVENUE AND COST ESTIMATES

24. In terms of revenue, the BRP anticipates very minimal international and regional travel in FY2021. However, the revenue per passenger assumed for this year is R4 516, which appears very high for passengers flying on domestic routes only. Further, the revenue per passenger is projected to increase only marginally over the remainder of the period (i.e. R5 161 by FY2025), which suggests that the revenue projections are not linked to expected route profiles or passenger mix. Cargo revenues make up 30% of total revenues in FY2021, but the BRP contains no information on how these projected revenues will be derived. Historically, Cargo revenues contributed approximately 6% of total revenues.

25. In terms of costs, we assessed the reasonableness of the BRP projections by comparing projections of each of the major cost items to projected revenue and checking whether these were consistent with SAA's historical performance. On this basis, we identified significant discrepancies for fuel cost, which is one of SAA's largest cost items, accounting for 30% of total costs in FY2019. For the past three reported financial years, fuel costs have accounted for between 25% and 30% of total SAA revenues. Conversely, the BRP shows that these costs will only account for between 10% and 15% of total revenues. A comparison of actual v BRP projections for fuel costs is shown in the Figure 1.
Figure 1: SAA Fuel costs % SAA revenue

Source: Genesis using SAA and BRP data

26. If fuel costs were set at 25% of total SAA revenue in line with historical performance (instead of 14% of total revenue), projected costs would be R7.8 billion higher over the five years to FY2025. Under this scenario, accumulated operating losses (as projected in the BRP) would increase from R4.8 billion to R12.6 billion over the same period. This outcome would totally undermine the financial merits of the BRP.

27. Figure 1 also shows that the projections for fuel costs in the current BRP are significantly lower than the fuel cost projections contained in the Draft BRP, which were between 21% and 34% of revenues. No explanation is given in the BRP for the marked reduction in assumed fuel costs as a percentage of revenues. In the absence of an explanation, the downward revision in fuel costs appears to be aimed at promoting the financial merits of the BRP, without regard to the actual level of fuel costs incurred by SAA.

28. In addition to fuel costs, the BRP also significantly understates the funding needed from government to implement the plan. The anticipated R2.8 billion working capital requirement is significantly lower than the up-front operating loss projections in the BRP. Excluding capex, retrenchment costs, concurrent creditor dividends, unfloated ticket liabilities and post-commencement creditors, the initial years losses are projected to be R3.2 billion in FY2021, R2.3 billion in FY2022 and R0.9 billion in FY2023 - the BRP financial projections are shown in the Appendix of this report. This means that the initial working capital injection needs to be R6.4 billion, and not R2.8 billion as disclosed in the BRP, and that the plan significantly understates the total funding required from government.

29. The BRP provides no alternative projections that are based on changes in underlying assumptions. In addition to the significant understating of fuel costs, there are other revenue or cost factors that need to be considered. Table 1 lists the risk factors associated with SAA’s revenues and cost, which we have identified. Each of these risk factors have the ability to undermine the financial merits of the BRP.

---

36 BRP, page 84
37 Annexure C BRP, page 148.
Table 1: Risk factors associated with the proposed BRP

<table>
<thead>
<tr>
<th>Affected Variable</th>
<th>Associated Risk</th>
</tr>
</thead>
</table>
| Revenue           | • Increased competition on profitable routes.  
                     • Uncertainty regarding the duration of Covid-19.  
                     • Less than expected demand for flights due to suppressed economy and fundamental changes in air travel post Covid-19. |
| Fuel costs        | • Volatile oil prices  
                     • Rand / Dollar fluctuations |
| Aircraft leases costs | • Rand / Dollar fluctuations |
| Labour costs      | • Wage negotiations and possible strike action |
| Governance        | • Lack of effective leadership  
                     • Instability  
                     • Poor decision making |

Source: Genesis

30. The BRP should include alternative projections that stress test revenue and costs to adverse outcomes with respect to the above revenue and cost factors. This approach would make the BRP compliant with Section 150 (3)(b) of the Companies Act, which allows for alternative projections based on varying assumptions and contingencies.

2.5. ECONOMIC VALUE OF PROJECTED FINANCIAL OUTCOMES

31. As explained in paragraph 13, the implementation of the BRP requires government to contribute R10.3 billion of incremental funding in addition to the amounts committed to secured lenders. This funding can only be justified from an economic perspective if the expected present value of future cashflows exceeds the amount of the funding. After accounting for one-off costs (retrenchments, concurrent creditors etc.) SAA is expected to incur significant negative cash flows in the first three years following Business Rescue and only achieve positive cashflow by FY2024.

32. Projected future cash flows beyond FY2025 are not disclosed in the BRP. As such, on the BRP as it stands, any further investments by government are loss-making. However, even if we make an assumption, which is not justified by anything contained in the BRP, that cash flow surpluses increase by an average of CPI inflation each year from FY2025 levels, the government will derive an internal rate of return ("IRR") of only 7% per annum from its R10.3 billion funding commitment, which is well below any reasonable estimate of SAA’s risk-weighted cost of capital. Even if SAA achieves the revenue and costs projections contained in the BRP, which as explained above, is highly unlikely, the government is at best expected to derive a return that is significantly lower than its own cost of capital, i.e. the cost of servicing its sovereign debt, which currently stands at 9.3%.\(^2\)

33. If SAA achieves a realistic projection of revenue and costs (e.g. including a reasonable allowance for fuel costs), the expected returns that will be derived by government will be significantly worse, i.e. negative. In short, the restructuring plan provides no reasonable prospects of success in achieving the BRP objectives, namely SAA continuing on a solvent basis. On this basis, the government (and taxpayers) would be significantly better

\(^2\) [Source: http://www.worldgovernmentbonds.com/country/south-africa/]
off allocating the proposed funding to other more urgent priorities and allowing SAA to be liquidated.

2.6. **IMPLICATIONS FOR SOUTH AFRICAN AIRLINE MARKET**

34. SAA's financial performance since FY2012 shows that the airline has effectively operated on a non-commercial basis for a number of years. Its continued existence is likely to have discouraged competition in the South African airline market as potential rivals do not have access to government funding to subsidise unprofitable routes.\(^{29}\) This is evidence by the exit of several local airlines, which have struggled to compete on level terms.\(^{30}\)

35. Evidence of SAA's ability to unfairly target rivals can be obtained from its FY2017 Integrated Report. The report discloses that the Competition Tribunal has awarded significant compensation to rivals for breaches by SAA of the Competition Act:

35.1. On 12 August 2016 the court awarded compensation of R104 million in favour of Nationwide.

35.2. In February 2017 the court awarded compensation of R1.1 billion in favour of Comair. As at Business Rescue date, SAA owed Comair R730 million of this competition\(^{31}\).

36. As explained in paragraph 17, many of SAA's routes will continue to operate on a loss-making basis, well after the business rescue process has concluded. With government funding, SAA will continue to operate loss-making routes. This is likely to prevent potentially more efficient operators from entering the market, and thereby denying consumers a choice of alternative airlines. Competition in the South African airline market would be best served if SAA were required to operate on sustainable commercial terms without continual government support.

---

\(^{29}\) Up to the Business Rescue date, Airlink was not a competitor to SAA as it operates under licence as a feeder airline using SAA's airline code.

\(^{30}\) Since 2012, four competing airlines have exited the market, including 1Time, Velvet Sky, Skywise and FlyBlueCrane

\(^{31}\) Annexure B of the BRP
3. CONCLUSION

37. In this report, we have identified crucial shortcomings in the BRP and the disclosed projections of SAA's revenues and costs. These include:

37.1. The failure to identify the true causes of SAA's failure, which include poor corporate governance and a sub-optimal route structure.

37.2. The lack of a robust financial feasibility that quantifies the expected returns to government and taxpayers from the proposed funding.

37.3. The proposal to cancel only 20% of SAA's routes despite 75% of the routes being loss-making.

37.4. The lack of disclosure of revenue and cost assumptions, which makes it impossible to understand how projected revenues and costs were derived.

37.5. A significant understatement of projected fuel costs, which render the financial projections wholly implausible.

37.6. A lack of alternative projections that stress test the financial projections to adverse outcomes with respect to the critical revenue and cost factors.

38. Due to the above shortcomings, the BRP does not provide a credible projection of SAA's future prospects. When correcting for the errors identified in this report, the BRP financial projections show that SAA has no reasonable prospects of being financially viable. In addition, continued government funding of SAA will undermine effective competition in the South African airline market.
## APPENDIX: BRP FINANCIAL PROJECTIONS

<table>
<thead>
<tr>
<th>Income statement</th>
<th>FY21</th>
<th>FY22</th>
<th>FY23</th>
<th>FY24</th>
<th>FY25</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passenger revenue</td>
<td>1 221 868 697</td>
<td>6 659 961 988</td>
<td>12 083 939 571</td>
<td>14 131 698 506</td>
<td>14 728 833 853</td>
</tr>
<tr>
<td>Ancillary revenue</td>
<td>7 522 969</td>
<td>139 133 472</td>
<td>445 955 943</td>
<td>675 909 815</td>
<td>920 530 235</td>
</tr>
<tr>
<td>Fuel surcharge</td>
<td>203 827 622</td>
<td>1 380 720 648</td>
<td>2 168 983 217</td>
<td>2 130 125 064</td>
<td>2 130 125 064</td>
</tr>
<tr>
<td>Cargo revenue</td>
<td>645 417 129</td>
<td>654 394 649</td>
<td>654 394 649</td>
<td>654 394 649</td>
<td>654 394 649</td>
</tr>
<tr>
<td>Other revenue</td>
<td>134 405 557</td>
<td>732 595 819</td>
<td>1 329 233 353</td>
<td>1 554 486 836</td>
<td>1 620 171 724</td>
</tr>
<tr>
<td>Total revenue</td>
<td>2 213 041 974</td>
<td>9 566 806 576</td>
<td>16 682 506 733</td>
<td>19 146 614 870</td>
<td>20 054 055 525</td>
</tr>
<tr>
<td>Fuel cost</td>
<td>169 856 352</td>
<td>1 391 599 202</td>
<td>2 593 127 951</td>
<td>2 497 684 576</td>
<td>2 497 684 576</td>
</tr>
<tr>
<td>Labour cost</td>
<td>1 475 074 645</td>
<td>1 927 721 065</td>
<td>2 587 301 275</td>
<td>2 802 627 993</td>
<td>2 935 784 423</td>
</tr>
<tr>
<td>Maintenance cost</td>
<td>755 453 575</td>
<td>2 421 125 894</td>
<td>3 890 182 547</td>
<td>3 754 346 259</td>
<td>4 211 596 527</td>
</tr>
<tr>
<td>Other operating cost</td>
<td>1 933 050 014</td>
<td>4 726 808 091</td>
<td>6 806 394 466</td>
<td>7 475 468 594</td>
<td>7 769 078 282</td>
</tr>
<tr>
<td>Total operating cost</td>
<td>4 333 434 586</td>
<td>10 467 254 252</td>
<td>15 877 006 239</td>
<td>16 530 127 422</td>
<td>17 414 143 808</td>
</tr>
<tr>
<td>EBITDA</td>
<td>2 120 392 612</td>
<td>900 447 676</td>
<td>805 500 494</td>
<td>2 616 487 448</td>
<td>2 639 911 717</td>
</tr>
<tr>
<td>Margin</td>
<td>-95.8%</td>
<td>-7.9%</td>
<td>4.8%</td>
<td>13.7%</td>
<td>13.2%</td>
</tr>
<tr>
<td>Leasing costs</td>
<td>754 575 011</td>
<td>989 739 152</td>
<td>1 446 806 734</td>
<td>1 567 373 962</td>
<td>1 687 941 190</td>
</tr>
<tr>
<td>EBITDA</td>
<td>2 874 967 623</td>
<td>1 890 186 828</td>
<td>641 306 240</td>
<td>1 049 113 486</td>
<td>951 970 527</td>
</tr>
<tr>
<td>Margin</td>
<td>-129.9%</td>
<td>-19.8%</td>
<td>-3.8%</td>
<td>5.5%</td>
<td>4.7%</td>
</tr>
<tr>
<td>Other costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>108 598 933</td>
<td>172 728 391</td>
<td>211 005 322</td>
<td>212 484 322</td>
<td>213 963 322</td>
</tr>
<tr>
<td>Financing costs</td>
<td>215 906 975</td>
<td>189 018 683</td>
<td>64 130 624</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total other costs</td>
<td>324 505 908</td>
<td>361 747 074</td>
<td>275 135 946</td>
<td>212 484 322</td>
<td>213 963 322</td>
</tr>
<tr>
<td>EBIT</td>
<td>3 199 477 932</td>
<td>2 251 933 902</td>
<td>916 442 186</td>
<td>836 629 164</td>
<td>738 007 205</td>
</tr>
<tr>
<td>Add depreciation</td>
<td>108 598 933</td>
<td>172 728 391</td>
<td>211 005 322</td>
<td>212 484 322</td>
<td>213 963 322</td>
</tr>
<tr>
<td>Capex</td>
<td>202 000 000</td>
<td>139 000 000</td>
<td>105 000 000</td>
<td>80 000 000</td>
<td>40 000 000</td>
</tr>
<tr>
<td>Operating cash flow</td>
<td>3 292 874 598</td>
<td>2 218 205 511</td>
<td>810 436 864</td>
<td>969 113 486</td>
<td>911 970 527</td>
</tr>
<tr>
<td>Retrenchment costs</td>
<td>2 200 000 000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concurrent creditors dividend</td>
<td>766 666 667</td>
<td>766 666 667</td>
<td>766 666 667</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unfown ticket liability</td>
<td>384 000 000</td>
<td>1 600 000 000</td>
<td>960 000 000</td>
<td>256 000 000</td>
<td></td>
</tr>
<tr>
<td>Post Commencement creditors</td>
<td>800 000 000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total one off costs</td>
<td>4 150 666 667</td>
<td>2 366 666 667</td>
<td>1 726 666 667</td>
<td>256 000 000</td>
<td></td>
</tr>
<tr>
<td>Cash flow</td>
<td>7 443 541 265</td>
<td>4 584 872 178</td>
<td>2 537 103 531</td>
<td>713 113 486</td>
<td>911 970 527</td>
</tr>
<tr>
<td>Cumulative cash flow</td>
<td>7 443 541 265</td>
<td>12 028 413 443</td>
<td>14 565 516 974</td>
<td>13 852 403 488</td>
<td>12 940 432 961</td>
</tr>
</tbody>
</table>