SAA Corporate Strategy

Presentation to Standing Committee on Finance

18 November - V12

SOUTH AFRICAN AIRWAYS

A STAR ALLIANCE MEMBER

Contents

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Purpose/Mandate of SAA (1/2)

SAA Mandate is to:

- *engage in passenger and cargo services*
- *to promote air links with business, trading and tourism markets*

SAA is required to pursue this Mandate in a manner that is:

- *financially sustainable,*
- *compliant with applicable operational regulations and legislation*
- *inclusive of laws and regulations aimed at transformation, skills development and employment equity*

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Purpose/Mandate of SAA(2/2)

Vision: "Africa's leading World-Class Airline"

Mission: "Deliver commercially sustainable world-class air passenger and aviation services in South African the African continent and to our tourism and trading partners".

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Strategic Objectives of SAA

Strategy

- Support South Africa's National Developmental Agenda
- To achieve and maintain commercial sustainability
- Provide excellent customer service
- Achieve consistent, efficient and effective operations
- Foster performance excellence

High Level Programs at SAA

LTTS Implementation Dashboard

Project	Strategic Objective (not limited to)	Accountable	Status Bar
Optimise Head Office Operation	Consistent, efficient and effective ops	CEO	
Establish an Effective Annual Governance Cycle	Foster Performance excellence	Company Secretary	
Fleet Restructuring	Achieve commercial sustainability	CFO	
Remediation of Loss-Making Routes: Int	Achieve commercial sustainability	GM Commercial	
Improvemement of Routes: Regional	Achieve commercial sustainability	GM Commercial	
Improvement of Routes: Domestic	Achieve commercial sustainability	GM Commercial	
Formation of Alliances	Achieve commercial sustainability	GM Commercial	
Mango Growth	Achieve commercial sustainability	CEO: Mango	
Balance Sheet Restructuring	Achieve commercial sustainability	CFO	
Cost Compression	Achieve commercial sustainability	CFO	
Performance Management	Foster Performance excellence	GM HR	
Human Capital Development	Foster Performance excellence	GM HR	
SAA Technical Strategic Growth	Achieve commercial sustainability	CEO SAAT	
Optimise Air Chefs Profitability	Achieve commercial sustainability	CEO Air Chefs	
Full Divisionalisation of SAA Cargo	Consistent, efficient and effective ops	GM Cargo	
Full Divisionalisation of SAA Voyager	Consistent, efficient and effective ops	Exec: Customer Loyalty	
Establish West African Hub	Achieve commercial sustainability	CSO	
Improved Operations	Provide excellent customer service	GM: Operations	
Implement LTTS Communication Plan	Foster Performance excellence	Exec: Comunications	
Customer Service Improvement	Provide excellent customer service	Exec: Customer	
Transition of IT to a Business Enabler	Consistent, efficient and effective ops	CIO	

Completed	On Schedule	At Risk	Behind Shedule

All of the above are aligned to our first strategic pillar to ***Support South Africa's national developmental agenda;***

Quarterly Performance Information

Summary of Shareholders Compact

Item #	Key Performance Area	Indicators	KPI	Actual Performance	
				Quarter 1	Quarter 2
1	Revenue	Revenue Generation Indicators	Revenue per Available Seat Km	8% below target	5% below target
			Revenue per Available Ton Km	9% below target	1% above target
2	Cost compression	Cost compression	Cost per Available Seat Km	4% over target	Achieved
3	Route Performance	Monthly Route Performance	Routes profitable	23 of 34	32 of 34
			Connecting revenue per ASK	21% below target	7% below
4	Ensure Financial Sustainability	Financial Ratios	6 KPI's - Ratios	Below targets	Below targets
5	Operational Profit	Financial performance	EBITDA (R M)	R138m below target	R361m below target
			Net Profit (R M)	R162m below target	Exceeded target with R167m
6	Refinement of the LTTS	Reports required	Reports Provided	1 our of 1	10 out of 14 provided
7	Human resources	Reports required	Reports Provided	1 our of 1	2 out of 2 provided
8	Procurement	Quarterly Reports	% spend locally	Exceeded	Exceeded
			% of local spend on BBBEE compliant companies	Exceeded	Exceeded
			% of local spend on Black owned entities	Not achieved yet	Not achieved
			% of local spend on Black SMMEs	Exceeded	Not achieved
			% of local spend on Black women owned	Not achieved	Not achieved
9	Customer focus	Quarterly Reports	% level of customer satisfaction	3% below target	5% below target
10	Effective Internal Control and Risk	Internal audit findings	No repeat and unresolved findings	N/A Yet	N/A Yet
11	Good Governance	Breaches of Materiality Framework	Number	None Reported	None Reported
12	Fleet Management and Performance	Quarterly Reports	Fuel burn rate	Exceeded target	Exceeded target
			Aircraft despatch reliability	Exceeded target	Exceeded target
			Narrow-body fleet average turn time	Achieved target	Below target
			Daily average wide-body fleet utilisation	Below target	Below target
13	Achieve Statutory Reporting Compliance	Statutory submissions made on time	Submission dates met/missed	Quarterly report submitted late	Annual Finance Statements outstanding. Q2 report submitted late
14	Co-ordination with other state-owned airlines	Quarterly Reports	Reports Provided	1 out of 1	4 out of 7 Provided

High Level Financial Performance (1/3)

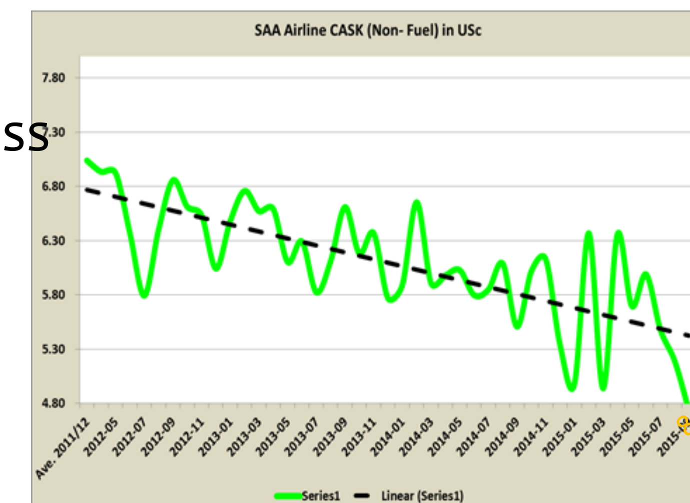
YTD Revenue is 10% below budget and down 6% against prior year

Economic downturn and competitor airlines continue to threaten our market as well as the unintended consequences of the immigration regulations (e.g. caused a reduction of 41% in children flying). This was mitigated by revenue initiatives taken by SAA.

YTD Operating Costs down 7% below budget, and 8% below prior year

Costs were well below last year, aided by lower fuel prices and cost compression initiatives. Cost control has been good with many expenses curtailed below inflation, but continuing weakness in the Rand has resulted in increased non-fuel expense Levels.

YTD savings R363million



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High Level Financial Performance

Weakening Exchange Rate had a R467m impact on the bottom line

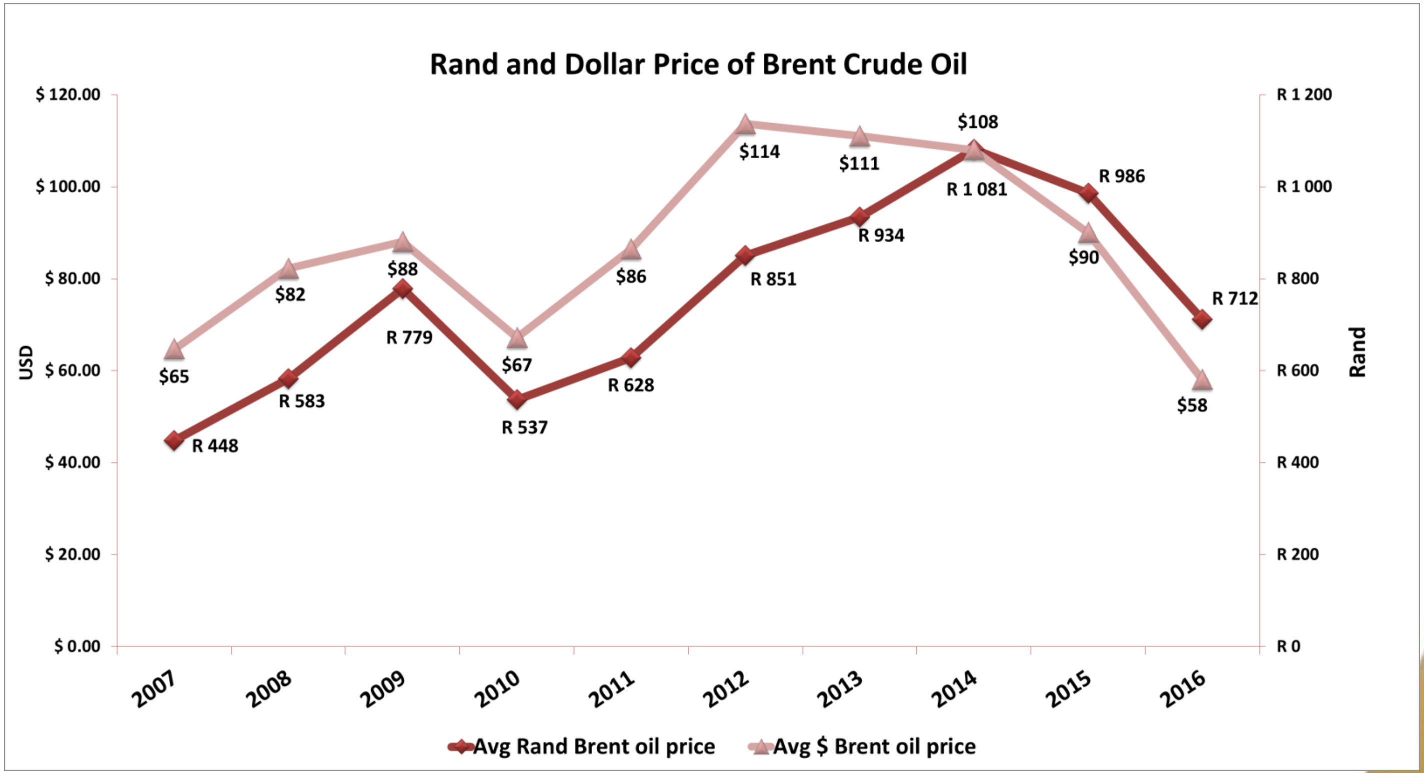
The ZAR/USD exchange rate has an impact on both revenue and operating costs.

Capex freeze:

A internal moratorium remains in place on all non-critical Capex

Fuel Price

The benefit of the lower fuel price was mostly negated by the weak Rand.



High Level Financial Performance (3/3)

In the 2nd quarter the Group recorded an operating profit of R354 million.

However the YTD position still reflected a net operating loss in line with budget.

	VAR VS BUDGET	VAR VS PRIOR YEAR
Operating costs	**7%**	**8%**
Energy	16%	32%
Labour	3%	-5%
Aircraft Maintenance	-9%	-17%
Other Operating Expenses	7%	-1%
Depreciation, impairment and other	-55%	29%
Net finance costs	-7%	>-100%

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Challenges and remedial steps (1/3)

Nr	Challenge	Risk	Mitigation
1	Weak balance sheet	The balance sheet does not provide sufficient security for funders (increases perceived credit risk) and government guarantees are thus required. As a result credit margins offered to SAA are higher. The total finance cost on funding loans has increased by almost 400% over the last 5 years.	1. Consolidation of debt. 2. Strategic focus to turn Airline cash positive in order to strengthen balance sheet.
2	Ageing fleet 	SAA's ageing wide-body fleet needs to be replaced by new generation twin engine aircraft with lower fuel consumption and maintenance costs.	The temporary solution is the negotiations to reduce lease rates on the extension of certain leases, as well as negotiated savings in maintenance reserves and return conditions.

Challenges and remedial steps (2/3)

Nr	Challenge	Risk	Mitigation
3	Weakening currency 	SAA is exposed to a number of macro-economic factors. A major element is the ZAR/USD exchange rate. Approximately 60% of SAA's operating costs are strong currency denominated (e.g. US$). Approximately 40% of the Group's revenue is strong currency denominated, which leaves the airline exposed with a net currency gap of approximately 20%. The negative impact of this currency exposure for the full current year is estimated in excess of R900m.	1. Hedging policies 2. Local purchasing where possible 3. Focus on growth of Strong Currency Revenue

Challenges and remedial steps (3/3)

Nr	Challenge	Risk	Mitigation
4	Lack of whole of state aviation approach	SAA continues to be impacted by the unintended consequences of government policies. E.g. the impact of the new onerous immigration and visa regulations is estimated in excess of R550m in the current year. Departments with policies that directly or indirectly impact SAA include Tourism, Transport, Economic Development, DIRCO and DTI.	Work with National Treasury to raise areas of concern
5	Legacy transactions 	Legacy transactions such as the A320 purchase transaction, with deliveries having been postponed to such an extent that the actual escalated purchase price at delivery by far exceeds the original purchase price. As a result, SAA had to recognise impairments in excess of R1 billion relating to the first ten deliveries. An additional R1.5 billion of impairments and a further cash flow drain to SAA of R1.5 billion are estimated on the second ten deliveries. Furthermore, auditors have been engaged to investigate causes of financial losses.	Currently re-negotiating A320 transaction.

Other Highlights from the Quarter

High level Financial Performance

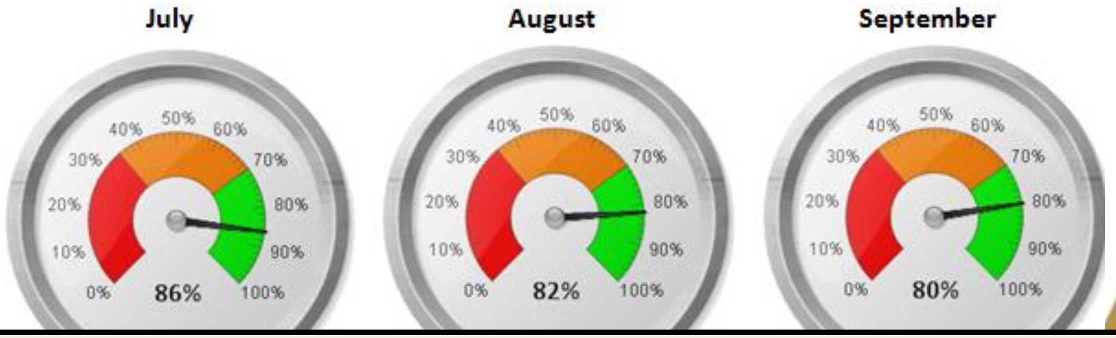
Renewed focus on LTTS implementation

- Continues awareness is being driven to ensure the whole company is aligned to the LTTS (e.g Strategy map distributed)

Performance Management as key pillars

- Significant progress was made with Performance and Consequence management. Calibration was done on the FY2014/15 performance results and Performance contractin for FY2015/16 is at 100%.

Customer Service, On-time Performance and Safety have not been compromised.



Customer Satisfaction Score

Questions from 2 Sep 2015 (1/10)

HR Questions

Questions	Answers
• Leadership instability with a lot of acting positions. Is there a process underway to fill these critical vacancies?	In the last four years SAA has been exposed to numerous changes at EXCO level, in particular with reference to the CEO position, and this is due to, inter alia; Board re-shuffling or as a result of performance and/or other related employment matters. Although these changes have contributed to leadership instability and negative employee morale, risk to the sustainability of the business has been managed by ensuring that acting arrangements are immediately put in place until permanent placement is secured. The CEO search process has been concluded; recommendations will shortly be submitted to the shareholder.
• Is there any prospect of staff reduction?	Yes we in the process of reducing staff. We have a moratorium on staff recruitment. Only critical positions are being filled.
• What explains the dramatic increase in headcount and spending on headcount at South African Airways between 2010 and 2014?	In 2010 employees that were procured through the labour brokers were absorbed into the company and converted into fixed-term contractors based on an agreement with organised labour. In 2013, these employees (and others on fixed-term contracts) were converted into permanent employees.

Questions from 2 Sep 2015 (2/10)

Financial Questions 1

Questions	Answers
• There is no financial plan to indicate in which year SAA will be profitable, is there any indication of the year?	According to the Corporate Plan SAA will be profitable at an operating level in 3 years, and fully profitable in 5 years.
• What was the impact of the equity injection on the balance sheet? What are the stop gap measures and how efficient are they? Can SAA be turned around without the further earmarked injection?	There has not been a capital injection and NT has indicated there will not be any. SAA continues to rely on debt funding on the back of Government Guarantees . This is extremely costly and contributes to the erosion of SAA's capital base. The estimated cost of funding for FY2016 will be in excess of R1 billion. SAA can be turned around without a capital injection, however, given the current macro-economic environment, this will only likely to occur in 5 years time. We remain hopeful that government will reconsider capital injection.
• What is the cost of non-commercial activities the SAA is engaged in?	SAA does not engage in non-commercial activities that are not prescribed by law.
• The presentation addressed external factors but what are the internal factors impacting on SAA's costs?	• Ageing aircraft • Weak balance sheet • Legacy transactions such as the A320 deal • Staff costs as a result of both headcount and the nature of

Questions from 2 Sep 2015 (3/10)

Financial Questions 2

Questions	Answers
• What are the five key root causes of the crisis, and what is being done to rectify it?	• Weak currency • Ageing fleet • Weak balance sheet • Lack of whole of state approach • Legacy transactions Mitigation is covered under the section: Challenges and Remedial Steps.
• Whether an investigation was conducted into a tender relating to the South African Airways Boeing 737 freighter aircraft; if so, what are the relevant details; if not, why not?	Yes, an investigation was conducted and the integrity of SAA's tender process was found not to have been compromised.
• Visa regulations are not the reason for the financial loss, as they are practically new. The financial loss is over a period of the last 3 – 5 years, so visa regulations cannot be blamed.	• Weak currency • Ageing fleet • Increasingly high funding costs • High fuel costs (to August 2014) • Legacy transactions resulting in high impairment charges

Questions from 2 Sep 2015 (4/10)

Commercial Questions

Questions	Answers
• **New visa regulations is reported to have had a huge impact, is there any indication of how much this is affecting the airline?**	The amended visa dispensation has had a profound impact on the South African tourism sector and the operations of SAA as well. It is clear when evaluating the reduction in the numbers of children travelling. The estimated EBIT loss due to the Unabridged Birth Certificates alone is estimated at R574 m per annum. Inbound passengers comparison: Jun – Sept 2015 vs 2014:

Category	PAX TY	PAX LY	Var%
Adult	1 253 148	1 343 029	(7%)
Child	29 392	50 049	(41%)
Infant	8 627	8 345	3%
Grand Total	**1 291 167**	**1 401 423**	**(8%)**

Furthermore, transit visas also present a serious hindrance to the development of ORT as a continental hub. We welcome the recent decisions by government in addressing these concerns.

Questions from 2 Sep 2015 (5/10)

Commercial Questions 2

Questions	Answers
• In light of the profitability of Mango, especially on the Durban route, why cancel the route at the expense of SAA?	• There are absolutely no plans to cancel the Durban - Johannesburg route. SAA has reduced capacity on this route by 15% year on year and carefully aligned its flight schedule together with Mango's in order to maximize connectivity into SAA's regional and intercontinental flights , while at the same time covering all possible times of day for the convenience of our point to point passengers. The results have met our expectations as the Durban route has now returned to profitability. In addition, the Board has approved the resuscitation of the Durban - Cape Town route.
• Ethiopian airlines is currently doing better than SAA, and they operate in the same or even less favourable conditions and climate. How is that possible?	• Ethiopian Airlines benefits from the advantages that SAA does not enjoy: - It operates in a "whole of state aviation policy" framework - It is capitalised and prioritised as an economic value driver by its state shareholder - similarly to Singapore Airlines or Emirates Airlines. - It benefits from leadership stability - It has newer long range fleet - Most importantly, its hub is located in the mid

Questions from 2 Sep 2015 (6/10)

Commercial Questions 3

Questions	Answers
• **What was the Emirates deal and why was it cancelled?**	Emirates is SAA's longest standing code share partner and SAA is, similarly, Emirates' first ever code share partner. The proposed agreement with Emirates is an expansion of their existing relationship through extending the codeshare, on a reciprocal basis, across their respective networks. The proposed agreement will accordingly generate additional options for passengers, such as the possibility of combining itineraries between the two airlines. The deal further proposes cooperation between the airlines on identified functional and operational areas. It has not been cancelled. The SAA Board is supportive of this deal and is consulting with a variety of stakeholders to ensure alignment regarding aspects of the proposed agreement and further steps are underway to bring the matter to finality.

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Questions from 2 Sep 2015 (7/10)

Shareholder & Transformation

Questions	Answers
• A follow up meeting with the Minister and shareholders is proposed.	The meeting is Scheduled for 18 November
• With regard to compliance with transformation, is there any information to share around broad based economic transformation?	SAA seeks to drive economic transformation by pursuing *Preferential Procurement* in a manner that not only transforms the airline's procurement spend, especially on commodities that comprise a sizeable portion of SAA's procurement spend, but also eases market entry for PDI owned SMME enterprises. This is an area that requires improvement.
• Are there black owned corporations that do business with SAA, and who are they?	Yes – SAA is doing Business with at least 29 black owned companies, making up 4% of our procurement spend.
• The performance of SAA cannot be evaluated without a shareholder compact.	A **summary** of the singed shareholders compact has been added in this pack. (Slide 7)

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Questions from 2 Sep 2015 (8/10)

Cargo and Mango

Questions	Answers
• Is SAA Cargo being sold to Bidvest? Employees seem to think this is the case and they fear retrenchments.	No
• Food items served on flights are made in other countries. Why is this and how is it procured?	On outbound flights food is procured locally. Where international brands are sourced it is through a local distributor. On return flights from international destinations we do serve food from the various destinations.

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Questions from 2 Sep 2015 (9/10)

Strategy Issues

Questions	Answers
• **It is important to distinguish between mandate, strategy and turn-around strategy.**	Our mandate is clearly defined as indicated in the first slides of this pack. The Long Term Turnaround Strategy (LTTS) guides our 3 year strategy.
• **How is this turnaround strategy different from all the others before it?**	The LTTS as drafted in 2013 is a holistic long term strategy created internally, addressing all core challenges of the business. Please note that the 90 day plan was not a new turnaround strategy, but a plan to expedite the quick wins of the 2013 LTTS. The implementation of the LTTS is continuing and showing successes in multiple areas e.g. Cost Compression (R2.3b + in savings)
• **The root causes of the problems have not been identified, only their effects.**	Much time is spent to trace the root cause of our challenges and find sustainable solutions to address them or mitigate the impact. The main focus of the LTTS was to identify these root causes and address them. (For example Productivity was identified as an issue, and headcount rationalisation was implemented.)

Route Causes address by the LTTS (9b/10)

Strategy Issues

A1. PROBLEM STATEMENT

SAA has an unsustainable Business Model created mainly by a challenging, dynamic and highly competitive trading environment and industry exacerbated by organisation specific weaknesses and inefficiencies

Major direct costs (particularly fuel) and competition (particularly from foreign airlines) have steadily increased and SAA's systemic weaknesses and inefficiencies have been increasingly exposed. Most have remained unaddressed for a long period resulting in progressively weighed down the performance of the organisation.

The principal problems facing SAA today are:

1. **The long-term weakness of SAA's Balance Sheet**, primarily caused by operating losses, hedging losses, and high fuel prices. This materially curtails SAA's ability to raise the capital required to finance its operations.
2. **High asset cost** – SAA's ageing aircraft fleet is expensive to hold and operate and utilises fuel inefficient technology. This means SAA incurs costs that it would otherwise not incur, had it operated more fuel-efficient new-generation fleet similar to those operated by its major international competitors.
3. **High people cost** – SAA staff productivity is generally low, resulting in the organisation not deriving the best value from its key asset: people. This is exacerbated by onerous and restrictive collective agreements, particularly with the pilots. Labour saving technology, particularly in the airports, is far behind acceptable global standards.
4. **Sub-optimal route network** – The allocation of capacity is not effectively aligned to either market demand or to the mandate of operating passenger and cargo services to South Africa's major trade and tourism partners. This is a particular problem in the domestic and long-haul international (non-African) markets. Domestically, SAA and Mango do not co-operate effectively with the State's other wholly-owned feeder airline, SA Express.
5. **Failure to address SA's Geographic Disadvantage** – While other global airlines, who are faced with a similar challenge, have implemented ways to minimise this impact, SAA has done nothing to address its end-of-hemisphere geographic location competitive disadvantage.
6. **Long-haul international business losing money** – The international route network is incurring substantial losses, with the last profitable year being 2004 and is facing increasing competition particularly from Emirates[1]. The Business Model for airlines similar to SAA has changed substantially, yet SAA has continued on the same path.
7. **SAA's profitable regional (African)** network is declining and its growth opportunities are constrained by the unavailability of bilateral rights. This means that SAA is unable to enter profitable routes in key African countries.
8. **SAA's domestic market is loss-making** and the market is rapidly commoditising, and has traded down to Low Cost Carriers (LCCs). Despite launching its own LCC subsidiary Mango in 2006, SAA still has a disproportionate percentage of its premium capacity (and therefore capital) allocated to a domestic market that is (in the main) demanding an LCC product.
9. **There is a lack of understanding of the balance of operating a commercial enterprise and supporting South Africa's developmental State policy objectives.** SAA often incorrectly interprets the Shareholder's intent, and without effective engagement, this can compromise the long-term commercial sustainability of the airline Group and therefore undermine the Shareholder's strategic intent.
10. **No 'Whole-of-State' aviation policy approach** – SAA's largest and/or fastest growing competitors such as the United Arab Emirates; Ethiopia; and Kenya operate their airlines under a holistic State Aviation policy framework. In those states, policy around airlines, airports, visa requirements, capital asset (aircraft) purchase, traffic rights for foreign airlines, etc are all co-ordinated to maximise the growth potential of their local airlines to achieve their Mandates. South Africa and SAA would benefit greatly from a similar approach.
11. **SAA suffers regular leadership changes, with the primary concern being the constant changes in the CEO and Executive Leadership Team**. Each new leadership regime finds a way to change the focus of the organisation to matters of the day rather than developing and implementing a long-term strategy.
12. **The governance of subsidiaries is not enabling the degree of independence required for them to flourish** and they are effectively treated as divisions of the airline.
13. Apart from Flight Operations, SAA Technical and Mango, **there is an almost total lack of performance and consequence management with no real culture of accountability.**
14. Despite often having good strategy, sometimes years ahead of the industry and competitors, **SAA has a poor record of strategy implementation**. Good strategy inputs have been developed internally and by a range of third-party advisors over the last decade, however it is seldom implemented either through a lack of accountability or the leadership of the day having a different view.
15. **Sub-optimally use information technology (particularly mobile and online platforms)** to improve distribution, customer service and the overall efficiency of the business.
16. **Inconsistent customer service** across the Group.
17. **Procurement is not optimised**, with SAA constantly paying too much for many goods and services.
18. **Poor management information systems and conflicting output from systems have led to a culture of strategies and commercial decisions based on flawed data**. Also, management reporting of key airline data, such as route profitability, is not effectively monitored or acted upon. This is greatly influenced by the lack of accountability.

These problems have been the principal cause of the adverse elements of SAA's long-term performance history outlined in the following Section. A SWOT Analysis is included in **Annexure B**.

1 Emirates (United Arab Emirates) grew from: ~25% of SAA's long-haul international scale in 2007; to ~85% in 2013 and operates from Johannesburg, Cape Town and Durban. This capacity/network reach into South Africa and lower economies of scale and efficiency driven pricing, draws passengers through their hub in Dubai.

Questions from 2 Sep 2015 (10/10)

General Issues

Questions	Answers
• When does the term of the board come to an end?	The term of the board comes to an end when a permanent Board is appointed.
• It seems that the SAA's leadership and management do not appreciate the enormity of the problems facing them.	The SAA leadership and management are well aware of the enormity of the problems and working very hard to address them as reflected in the Corporate Plan and Shareholder Compact.
• Whilst agreeing that external factors do cause problems, there are also internal factors, such as the board chairperson, who is too powerful and should be held accountable.	We have no knowledge of this
• Did the chairperson receive a call from the president or a representative of the shareholder to terminate a proposed deal with Emirates at the last minute, as was largely publicised?	We have no knowledge of this

THANK YOU

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