BROADBAND INFRACO (BBI) : FINANCIAL AND OPERATIONAL OVERVIEW

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national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

OPERATING ENVIRONMENT

BROADBAND INFRACO (BBI)

- The BBI Act came into effect in 2007, however the company only obtained an Electronic Communications Network Services Licence ("ECNS") in October 2009 and only launched its services in 2010. This resulted in a three year operational delay, which proved detrimental to the future success and impact of BBI in the ICT sector.

- Originally BBI was to extend the availability of electronic communications to underdeveloped and underserviced areas. Acting to remove (backbone) infrastructure impediments in a vertically integrated market.

- BBI was to present a low cost access carrier network. However, the delays in the entry and licensing of BBI resulted in MTN, Neotel, and Vodacom entering into co-build ventures to build their own network. This essentially presented alternative national infrastructure networks, undermining the viability of BBI's business model. Companies like Dark Fibre Africa (DFA) are also able to provide open access networks.

- BBI has struggled to remain relevant since, plagued by a lack of client/revenue diversification (Neotel being its main client for a number of years), poor network reliability, and limited network presence, given that the private sector already have networks in the golden triangle (Gauteng, Durban and Cape town).

BROADBAND INFRACO (BBI)

- Given the introduction of the new ECNS licenses, network operators are able to and do provide for their own network requirements. Furthermore, the goal of SA Connect, is to provide broadband access across the country.

- BBI is currently struggling to compete because of its lack of aggregation and access fibre, which places it at a disadvantage to competitors. Furthermore, there are private sector players who are able to offer access to and build open access networks.

- As part of the ICT Policy Review, the DTPS analysed the mandates of all ICT entities with the aim of repositioning and rationalising entities to eliminate inefficiencies and avoid duplication of mandates and resources. BBI was identified as one of the entities to be rationalised. The exact process is yet to be detailed.

- It would be advisable that a steering committee be established between the relevant departments and that a transaction advisor be appointed in order to expedite rationalisation process.

PREVIOUS FUNDING ALLOCATIONS/GUARANTEE APPLICATIONS

- A total of R1.8 billion has been allocated to BBI since its inception. A final allocation of R140 million was made in the 2010/11 financial year. BBI was expected to operate on a commercial basis.

- During the 2014 budget process, BBI's bid was dismissed. A policy decision had already been taken to rationalise the entities in the sector. In the constrained fiscal environment, delays in this process requiring that funds be allocated to companies like BBI would not be tolerated.

- BBI has submitted a funding application for the Medium Term Expenditure Framework (MTEF) 2015. BBI submitted a five year funding request which is not congruent with its two year rationalisation process. After revising their request in line with the MTEF framework, the request totalled R932 million over the 2017/18 and 18/19 financial years. The request will be evaluated against other funding requests received.

PREVIOUS FUNDING ALLOCATIONS/GUARANTEE APPLICATIONS

- A formal request for a going concern guarantee (R243 million) was submitted to the National Treasury. The National Treasury has met with BBI and its auditors regarding the going concern requirement. The application will be reviewed. It will be assessed against the ability of BBI to repay any debt raised against the guarantee that is being requested, the broader strategic decision on the rationalisation of BBI and the risk posed to the fiscus.

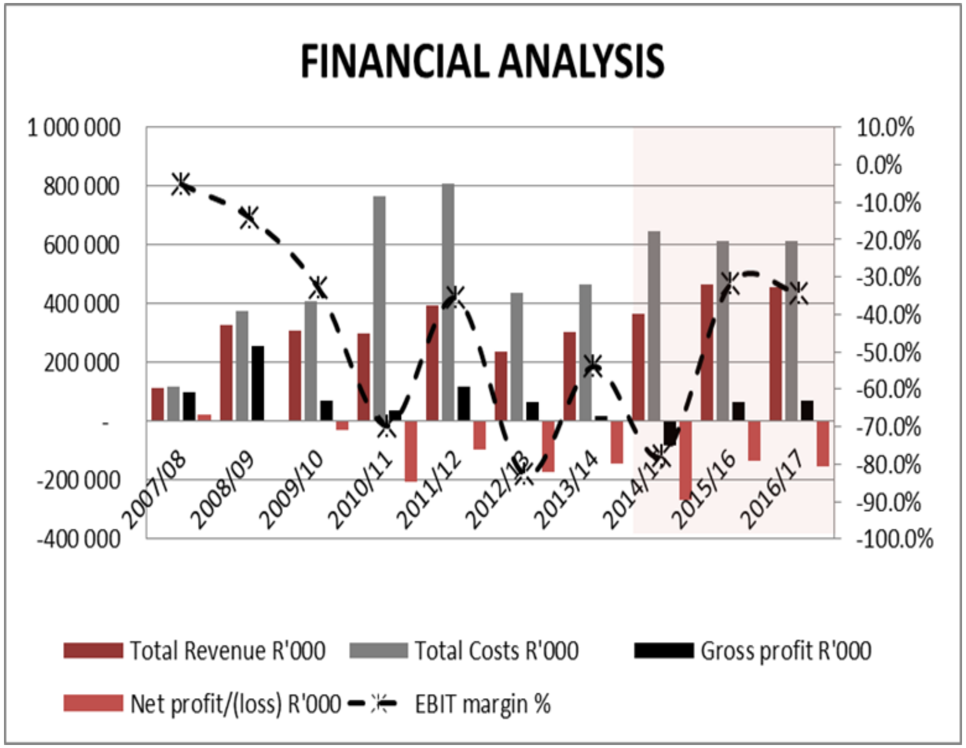
- The National Treasury has on numerous occasions advised BBI that it should reduce its capital expenditure. However, BBI proceeded to enter into various contracts, with the management being aware that BBI did not have sufficient funding to provide for the upfront capital outlay required. (This is also as a result of BBI not having scale in terms of the aggregation/access fibre, making it very costly for BBI to services these new clients.)

FINANCIAL ANALYSIS

HISTORICAL FINANCIAL PERFORMANCE

Income Statement			Historical				
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Total Revenue R'000	112 316	326 449	306 400	297 560	393 563	237 374	302 373
Net Profit/ (Loss) R'000	22560	101	-28 312	-206 932	-95 222	-181 071	-143 484
Revenue							
Turnover growth %	100.00%	190.70%	12.00%	-2.90%	32.30%	-39.70%	27.38%
Costs							
Operating cost growth %	100.00%	196.00%	-43.00%	41.40%	5.90%	-17.48%	5.87%
Profitability and Efficiency							
Operating expenses –to- Revenue %	91.00%	92.70%	56.30%	169.80%	135.70%	110.20%	103.30%
EBITDA margin %	22.70%	16.30%	-3.20%	-27.30%	-6.80%	-34.30%	-12.10%
EBIT margin %	-5.20%	-14.20%	-33.00%	-69.80%	-35.70%	-82.80%	-53.90%
Net Profit margin %	20.10%	0.00%	-9.20%	-69.50%	-24.20%	-73.40%	-47.45%
Balance Sheet							
Total Equity R'000	654 009	1 383 867	1 637 352	1 617 717	1 522 495	1 341 424	1 208 351
Total debt R'000	681 048	134 998	7 749	89 459	174 014	261 796	884 733
Solvency							
Gearing ratio %	0%	10%	0%	6%	11%	20%	73%
Liquidity							
Current ratio	1.1	7.5	12.6	9.3	6.1	2.2	1.99

HISTORICAL FINANCIAL ANALYSIS



- Revenue has shown an immaterial compounded annual growth rate (CAGR) in the five year historic period to 2013/14 of -0.26%. This was largely due to the over-dependency on one major client.
- Cost of sales has shown a contracted CAGR over a five year historic period of -8.2% mainly due to the high fixed cost structure of the service provided. Operating expenditure has shown a substantial CAGR over a five year historic period of 12.6%, mainly due to employee expenses which increased above inflation year-on-year.
- BBI initially made a profit in 2007/08 it's first year of operation and as it matured it has incurred losses every year thereafter. BBI recorded a net loss of R143 million for the 2013/14 financial year. This is mainly due to a higher increase in costs than revenues year-on-year.
- BBI has not revised its tariffs since its initial filing with ICASA in October 2010. However, the costs of providing the services have increased substantially from 2010 to date. This has led to a mismatch and results in the inability to recover the costs of proving services with the revenue generated
- The current ratio has been deteriorating indicating the entity's inability to meet their debt as it becomes due.

FINANCIAL ANALYSIS

Revised Corporate Plan Projections

Key Financial Ratios	2014/15 Unaudited	2015/16 Bugdet	2016/17 Forecast
Income Statement			
Total revenue (R'000)	364 048	465 251	457 267
Net profit/loss (R'000)	-267 886	-135 417	-152 223
Turnover growth	20%	28%	-2%
Total cost growth	36%	-10%	-3%
Profitability			
EBITDA margin	-41%	-2%	-3%
EBIT margin			
Net Profit Margin	-74%	-29%	-33%
Balance Sheet			
Total equity (Rmil)	941	805	653
Total debt (R'mil)	791	922	856
Total Assets (R'mil)	1 731	1 727	1 509
Solvency			
Gearing	0.84	1.15	1.31
Debt ratio	0.46	0.53	0.57
Interest cover	-17.54	-10.89	-29.66
Liquidity			
Current ratio	1.70	1.34	0.91

- Revenues are projected to increase by 20% to R364 million (2014: R302 million) mainly attributable to the addition of two new major clients, SITA and Cell C. Neotel is still the chief contributor to revenue although its contribution is expected to go down from 62% to 42% and together these major clients are anticipated to contribute approximately 80% of the total revenue.
- Cost of sales are forecast to increase by 106.6% to R316 million after contracting by 11% to R153 million in the prior year. The spike is mainly due to additional costs attracted by the new contracts concluded with SITA and Cell C.
- Operating expenses (OPEX) are expected to increase by 3.2% to R331 million (2014: R312 million). The key drivers are depreciation costs and employee costs which jointly contribute 76%.
- BBI posted its highest loss to date of R268 million in 2014/15, a 87% increase from the prior year loss of R143 million. This is mainly attributable to a significant increase in the Cost of sales which doubled when compared to the prior year.
- There was a decrease of the current ratio to 1.7 (2014: 2.0). The decline in the ratio is mainly due the decrease in cash and cash equivalents.
- Total cash and cash equivalents at the end of the year decreased by 64.5% to R157 million (2014: R442 million). This is mainly due to a 141.8% decrease in net cash generated from operations from a positive R309 million in the prior to a negative R153 million in the current year.

CONCLUSIONS

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- At the time of establishing BBI, there was a market gap that needed to be addressed as a result of the market dominance of the Telkom monopoly.
- However due to delays with licensing BBI and policy shifts (self provisioning) moving the sector from one that is based on infrastructure competition to competition based on services, the strategic requirement for BBI is no longer as relevant.
- SA Connect is the policy framework that will guide the roll out of broadband through-out the country. In line with SA Connect, the MTPS has advised BBI that it will be rationalised within two years.
- BBI has made losses for the past five years and will continue to do so for the forecasted period. Although the entity advises that it will make net profits in the medium term, this is uncertain at this stage.
- The rationalisation process needs to be expedited. It is advisable that a Steering Committee be set up between the relevant Departments and that a transaction advisor be appointed to evaluate different options for rationalising BBI.