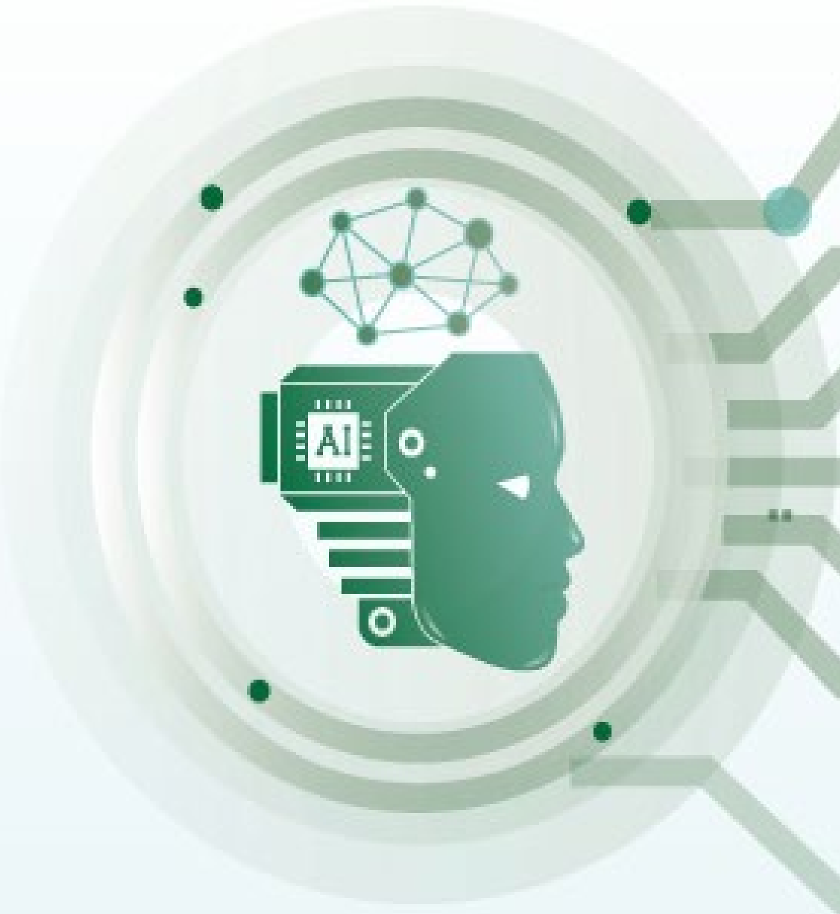
communications & digital technologies
Department:
Communications & Digital Technologies
REPUBLIC OF SOUTH AFRICA



ESTABLISHMENT OF THE STATE DIGITAL INFRASTRUCTURE COMPANY

29 October 2024

PURPOSE AND OBJECTIVE OF RATIONALISATION

- Informed by various Government policy provisions, including the Presidential Review Committee (PRC), the National Development Plan (NDP), SA Connect, and the ICT Policy White Paper, the Department embarked on a project to rationalise the entities under its portfolio.
- The aim of the State-Owned Entities (SOE) rationalisation project is to harmonise SOEs within the portfolio to form a logically coherent/common carrier agent(s) for efficient delivery of ICT services to South African Citizens. This would move away from the current fragmented mode of service delivery and towards a more consolidated and focused approach (ICT infrastructure and services).
- The Department has ICT infrastructure and services capacity duplicated across SOEs under its portfolio which if streamlined, can be effectively utilised in the best interest of service delivery and therefore, the SOE rationalisation project aims to address such duplication of resources.

PROS AND CONS OF RATIONALISATION

Pros:

- The strategic appropriateness of the merger between SENTECH and BBI is premised on the grounds that both organisations operate in the broadband industry albeit using two different technologies.
- SENTECH uses wireless broadband whilst BBI focuses on optic fibre infrastructure. The merged entity will accordingly be positioning itself as an open access network and the last mile provider of broadband solutions to the public sector with a focus on schools, health facilities, and high data usage organs of the state.
- It will have a nationwide network providing significant coverage for both Radio and TV with its terrestrial and DTH platforms. It will also contribute to the fulfilment of the content distribution mandate and universal access.
- BBI and SENTECH's infrastructure are complementary, and the merged entity will benefit from an expanded service delivery capacity. It will likely utilise the existing SENTECH national support structure and the management of PoP will accordingly be undertaken from the current SENTECH's regional presence points providing an immediate and cost-effective benefit to BBI.

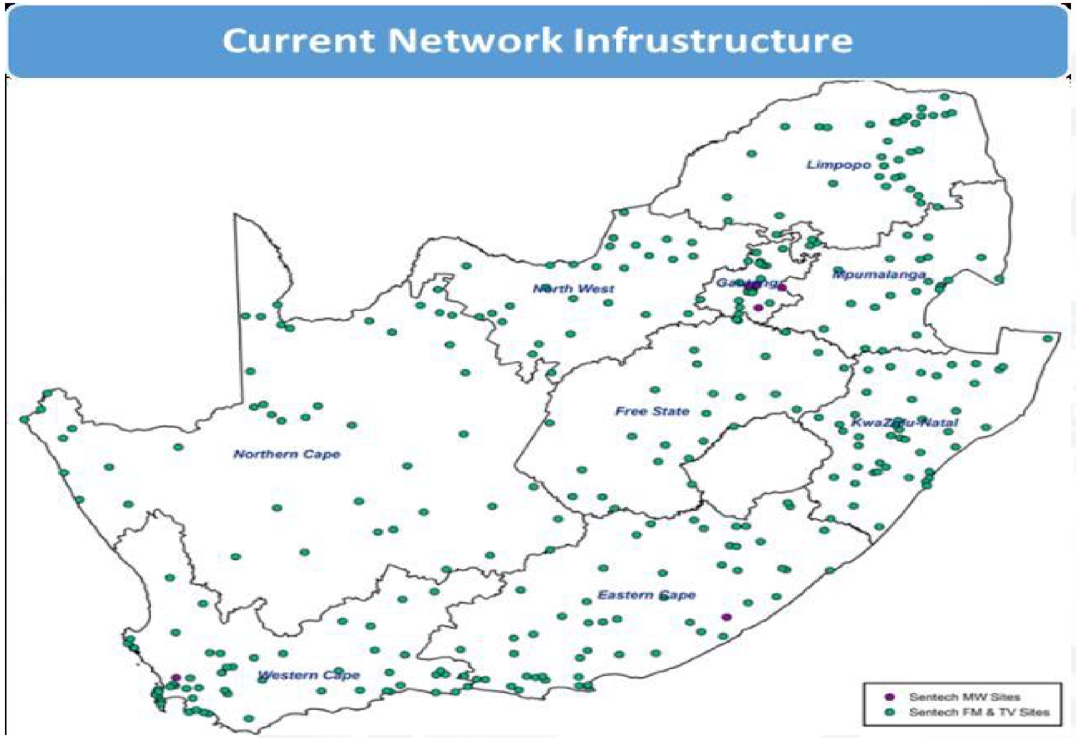
MERGED ENTITY COMPLEMENTARITY CAPABILITIES

	FOR SENTECH	FOR BBI
Transmitter Sites	Provides the base for site location	Mast colocation business enhanced by access to SENTECH sites
Fibre Capacity	Very little fibre in its network and significant fibre requirements to service high sites.	Provides the basis for high site connectivity
Wireless Broadband Capabilities	Strong wireless capabilities which can be used for high-speed, high-capacity connections particularly where fibre is not feasible in under serviced areas	SENTECH's wireless capabilities can enhance offerings to broadband clients
National Operating Centre	Synergistic sharing of NOC capabilities and infrastructure with BBI	Has already developed plans for NOC as a service
Business Systems	Requires a detailed due diligence but conceptually, synergies should be possible in OSS and BSS systems	
Sales	Requires a detailed due diligence and the market focus of the two companies is somewhat different but synergies and cross-selling should be possible.	

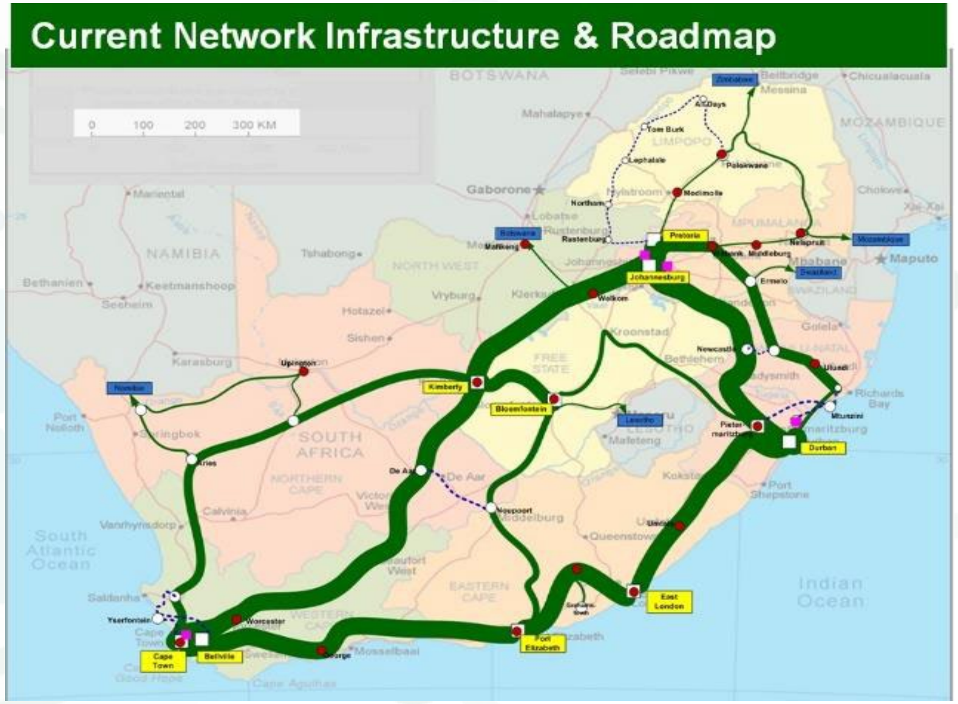
PROS AND CONS OF RATIONALISATION CONT.

The side-by-side network topologies below present SENTECH's network, which will be complemented by the BBI's infrastructure to strengthen the content delivery backbone network is depicted in the figure below:

SENTECH



BBI



The merged entity will ensure the use of existing services and expansion of infrastructure capabilities to ensure South Africa remains connected to the rest of the continent and the world through both the East and West Coast undersea cables ensuring built in infrastructure redundancy.

CONS OF RATIONALISATION

Cons:

- The legal opinion sought from the Office State Law Advisor ("OSLA") was that the merger can be implemented more rapidly through Chapter 5 of the Company's Act i.e., "fundamental transactions, takeovers and offers".
- One of the main requirements of the Company's Act is section 113 (1) which requires that each merged company will have to satisfy the solvency and liquidity test.
- Following this, the department decided that Sentech should acquire BBI to fast-track the implementation of the legal opinion from the OSLA.
- As such SENTECH performed the financial due diligence on BBI and determined that pursuing the acquisition would likely result in severe financial strain on both entities, potentially leading to operational inefficiencies and jeopardising service delivery.
- The summary of the outcomes of the due diligence on BBI by Sentech are summarised in the next slides

RATIONALISATION ACQUISITION OF BBI BY SENTECH

The outcomes of the due diligence on BBI by Sentech are summarised as follows:

1. BBI Weak balance sheet position

- Sustained going concern and solvency risk due to ongoing operating losses installed, declining revenues and margins compression even after debt-to-equity conversion of R1.83 billion in April 2021 to address negative equity position because of accumulated losses
- The NAV position of R273m will be further eroded by expected losses of R160m which implies that BBI is more than likely to be technically insolvent again in early FY2024
- Unable to meet financial obligations (operating and otherwise) as and when they become due as a result of lack of liquidity and declining (negative) cash generation profile
- Increasing fibre network infrastructure degradation due to relatively low repairs and maintenance further threatens the ability to generate future revenue and more impairments
- Only servitudes and rights of use are recognised as intangible assets, owns way-leaves where fibre cables are installed, and sites or offices are leased
- Highly doubtful to generate positive cash flows from operations in the near future due to lack of requisite capital expenditure to realise growth plans

RATIONALISATION SENTECH ACQUIRING

2. BBI's Compromised commercial proposition

- 7 774 km out of the aged 14 958km operated fibre network infrastructure is leased from Eskom and Transnet and contributes more than 85% of the operations and revenue
- The network book value of R822m on the balance sheet only contributes 15% to BBI's operations (revenue)
- The cost of the fibre leases and maintenance contract has not seen the same or higher revenue and usage to warrant the viability of the routes
- Aging network infrastructure which has not been adequately maintained or upgraded over the last few years due to the inability to borrow and upgrade the network for better service offerings.
- The Maintenance Agreements with Transnet and Eskom are not confirmed.

3. BBI Financial performance

- Use of price discounting to retain market share (customers) due to increased competition and unreliable service offerings resulted in ongoing reduction of trading margins. The gross profit margin has been reducing.
- Inability to rationalise/reduce operating costs due to lack of buying/negotiating power negatively impacts operating margins.
- As at Quarter 1 of the current financial year (2024/25) BBI is technically insolvent and its liquidity ratio is less than 1, which suggests that its assets are not sufficient to cover its long-term liabilities and that BBI is not able to settle its short-term current liabilities.

CURRENT STATUS

- Having considered the challenges raised in the Sentech due diligence report the department requested the two entities to develop a turnaround strategy for BBI and find ways to mitigate some of the requirements.
- On 31 May 2024, BBI submitted to the department the turn-around strategy. The turnaround strategy can be summarised as follows:
  - A total of R2.3Bn funding is required to turn around the company over the next four years with a projected Internal Rate of Return of 14.96% with positive NPV.
  - SA Connect CapEx funding over the next two years has addressed the immediate funding needs of BBI, totaling R518m and R818m for year 1 and year 2, respectively:
    - Capital investment of R1.3 billion including VAT for the network upgrade and technology refresh to aggregate SA Connect traffic, for revenue protection and revenue generation.
    - Working capital of R120m incl VAT for the 2024/25 managed services capacity requirements and project resources
    - R209m including VAT is required to partially pay Eskom and Transnet liabilities for 2024/25

FUNDING CONSIDERATIONS

The DCDT, SENTECH and BBI engaged to explore funding alternatives regarding the implementation of the Merger.

Funding Required	Amount R'000	20% Equity	80% Debt
Capex	848 268	169 654	678 614
Working Capital	328 992	65 798	263 194
	1 177 260	235 452	941 808
Cost of funding	Weight	Return /Interest	WACC
Equity	20%	22%	4.4%
Debt	80%	14.25%	8.32%
	100%		12.72%

- Sentech's equity contribution will amount to **R267m,** based on the 74% Shareholding.
- Prime Interest of 10.75% was used as a base plus the Risk Premium of 3.5% with final interest rate at 14.25%, the 3.5% is forward looking at the current interest rates changes which is on the upward trend and the risk profile of the business.
- Funding will be sourced from Shareholders' equity which include current shareholders and Sentech as new shareholder. In addition, debt funding will be sourced from both commercial and Development Financial institutions. Sentech will ensure optimal capital structure is maintained in funding the turnaround.

PROPOSED OPTIONS AND WAY-FORWARD

- Considering that BBI's turn-around strategy will take longer than anticipated, the department is working on the Terms of Reference (TORs) to appoint a transactional advisor to provide a thorough situational analysis and advise on the best legal framework that includes but is not limited to the following options:
  - Review the current business cases to determine the feasibility of merging Sentech and BBI outside the Companies' Act provisions.
  - Explore the establishment of an SDIC and allow the consolidation/access to other state digital infrastructure within the other State-Owned Entities like (Transnet, Eskom, SANRAL and Municipal infrastructures across the country). BBI and Sentech will then be transferred under the SDIC.
- The department intends to appoint a transactional advisor soon. Preliminary recommendations will be implemented as and when they become feasible to avoid any further implementation delays.
- The department, BBI and Sentech will continue to explore the funding avenues to cover the R1.8bn required to capitalize BBI.

ROADMAP TO CONCLUSION

Q3 2024	Q4 2024	Q1 2025	Q2 2025
Appointment of the Transactional Advisor	Commencement of the Revision of the Business Case for the SDIC	Exploration of the options identified in the situational analysis	Finalization of the business case and situational analysis.

Q3 2025, commencement the implementation of the outcomes of the SDIC revised business case. This will be followed by commencement of the SDIC Bill process.

This will include the following activities:

- Obtain Office of the State Law Advisor Certification
- Obtaining National Treasury and DPSA approval
- Obtain DPME SEIAS Certification
- Consultations with relevant Clusters
- Revised SDIC Bill submitted to Cabinet for approval to introduce to Parliament


Thank You
Ngiyathokoza
Enkosi
Ke a leboha
Ndo livhuwa
Ke a leboga
Ngiyabonga
Ndza khensa
Dankie
AI