PRESENTATION TO APPROPRIATIONS COMMITTEE

DPE and ESKOM
12 June 2015

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REPUBLIC OF SOUTH AFRICA

Eskom

Agenda

Introduction

Cabinet approved support package

Conversion of the subordinated loan

Nersa selective reopener

Conclusion

Eskom management will primarily focus on 3 primary issues in the short term over the next 100 days

Liquidity

Eskom will focus on it’s liquidity position to **ensure financial viability**

Operational performance

Eskom will focus on improving operational performance by **prioritizing critical maintenance**, with the aim of doing maintenance **without load-shedding**

Governance

The third issue of Governance will be **dealt with by the CE and Board**

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In 2014 Eskom made an application to Government for a support package

Option Rank	Solution Option				Tradeoff						
	Capital Spend Rbn	% Eskom Savings Achieved	% Average Price increase 2015/16/17	Government Contribution Rbn	Impact on Credit Rating	Impact on Cash Flow	Affordability/ Competitiveness (Ave Price c/kWh Real by 2018)		Reasonable ROA by 2018		Long term sustain-ability
1	300	75	13 x 3	R50bn Equity	✓	✓	81	✓	4.70%	✗	✓
2	300	75	13 x 3	R38bn Equity	✓	✓	81	✓	3.70%	✗	✗
3	300	75	11 x 3	R55bn Equity	✓	✓	77	✓	2.40%	✗	✗
5	300	75	19 x 3	-	✓	✓	95	✗	7.7%	✓	✓
7	300	75	16,14,14	R16bn Equity	✓	✓	85	✗	4.70%	✗	✓
8	300	75	16,14,14	R30bn Equity	✓	✓	85	✗	4.80%	✗	✓
9	250	75	11 x 3	R15bn	✗	✓	77	✓	2.40%	✗	✗
Base Case	250	100	8 x 5	-	✗	✗	71	✓	1.10%	✗	✗

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On 11 September 2014 Cabinet approved a R23bn equity support package for Eskom

Tariffs

- Approved **support** for Eskom in applying for an **overall tariff increase as determined by NERSA** for the remainder of MYPD3
- The support takes into account the **R7.8bn already approved by Nersa** in terms of the **regulatory clearing account**

Equity

- An **equity injection of R23bn** will be given to Eskom to help **relieve the impact on electricity customers**

Subordinated loan and debt

- **Conversion of the subordinated loan** to equity was granted
- In addition to R200bn debt in MYPD3, Eskom will have to **raise additional debt of R52bn**

Eskom efficiency

- Eskom will implement **cost containment program**
- **Effective manage the build programme**
- Eskom should **not invest in future coal mines**
- **No provision** to be made for the **additional R50bn Capex requirement**
- Eskom must **better manage its working capital**
- Eskom needs to ensure that **effective maintenance of its generation plants** is carried out and **efficient procurement** is achieved, amongst others

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SOURCE: *Cabinet-Approved Package to Support a Strong Eskom and the Attainment of Energy Security* – Letter from the Minister of Public Enterprises to the Eskom Chairperson, 16-Sep-2014

Early projections indicate that the Eskom financial position is under pressure

Key performance metrics updated based on Government support package

KEY FINANCIAL PERFORMANCE METRICS		Investment grade	'13/14	'14/15	'15/16	'16/17	'17/18
Profit after tax	R'mill		5 446	2 796	-5 191	393	16 456
Liquid assets (cash- Nominal)	R'mill		12 842	12 787	20 430	20 174	32 159
Leverage ratio (FFO : Total debt)	%	> 20	5.2%	2.4%	4.6%	8.1%	14.2%
Total debt : EBITDA	Ratio	< 3	11.0	13.3	13.3	8.6	5.6
Debt : Equity (incl provisions)	Ratio		2.7	2.7	2.3	2.5	2.3
Debt service coverage ratio	Ratio	> 2.5	0.4	0.8	1.0	1.9	2.5
Interest cover	Ratio		0.8	0.4	0.2	0.7	1.4
Debt drawdowns	R'mill		52 752	49 300	58 029	44 328	35 006
Equity	R'mill		-	-	20 000	3 000	-

Based on original modelling data

Insights

- A Government **equity support package for R23bn** was approved
- The combination of **price increases**, business efficiency savings through **BPP success**, **extra borrowings** and **equity injection** will result in an improvement of financial metrics over the period with **favourable ratios** being reached in **2017/18**

Red (not met)
Orange (current single B)
Risky/Yellow (1 notch up)
Met/Green (2 notch up)

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In 2008 a subordinated loan was granted to Eskom which is viewed by rating agency Moodys as 50% equity

History of subordinated loan

- Eskom was granted a subordinated loan facility by Government of R60bn in December 2008
- Eskom pays a fixed interest rate on each tranche of the loan, but only if the leverage and interest cover ratios as defined are favourable

Liability vs. equity

- On initial recognition R30.5bn was classified as equity and R29.5bn as a loan liability based on Eskom's assumed financial ratios
- The valuation of the liability gets reviewed on an annual basis and, if deemed appropriate, re-measured
- The liability was valued at R27bn as of 31 May 2015

Conversion of the loan

- Should this loan get converted to equity - the shareholder effectively "forgives the debt"
- Eskom's financial position (debt/equity ratio) will improve as debt reduces and equity increases
- Eskom does not have to repay this loan, thus, freeing up borrowing capacity

In 2008 the subordinated loan was required to support and stabilise credit ratings

- In August 2008 Eskom was **downgraded by Moodys** by an unprecedented 4 notches in local currency (3 in foreign currency) and left the **credit outlook on negative** view. In addition, **S&P** had placed Eskom on **Negative Credit Watch**
- Main reasons for the downgrade were
  - large scale **capital expenditure**,
  - with **little contribution to incremental earnings** in the medium term,
  - **tariff increases below** those **requested by Eskom** and required for the capital expenditure, and
  - positively, present strong support by the Government, with an element of **uncertainty as to future behavior towards Eskom**
- Eskom's **ability to source its funding** requirements was **hugely dented** by these actions
- In order to **support and stabilise the credit ratings** and assist Eskom's financial sustainability, **Government** agreed to provide **approved a R60 billion subordinated loan to Eskom**, flowing over 3 financial years

Conversion of the loan will improve key financial ratios and help defend the vulnerable credit ratings

- The loan is subordinated to **Eskom's senior debt**, receiving **100% equity credit from S&P** and **50% equity credit from Moody's**
- The Government could **convert the loan outright** to equity to show their **commitment to further support Eskom**, but the conversion will **not have a material effect** on **Eskom's rating** since it receives substantial equity treatment already
- The loan does **not generate any incremental revenue** nor cash or **debt service relief** as it is **currently not being serviced**, however, were Eskom's financial situation to improve an estimated **R86bn could be reduced** in future **cash interest expense**
- From Eskom's perspective a conversion to equity would **help defend and over time recover investment credit ratings** (current ratings: **Moody's (ba1 Stable)** and **S&P (BB+ Negative Outlook)**)
- Over the remainder of the MYPD3 the **impact on the financial ratios** are estimated to be an increase of:
  - **0.03 - 0.11 on the interest cover ratio**
  - **0.88 - 0.92 on the debt / equity ratio**

Conclusion

- **Conversion of the subordinated loan** is critical to Eskom as it will
  - improve the **balance sheet position**
  - improve financial ratios which affect the **position with rating agencies**, and
  - free up **additional borrowing capacity**
- Implementation of the selective reopener is critical to ensure the business is in a positive financial position in FY16 in terms of **liquidity** and **profitability.**

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Thank You

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