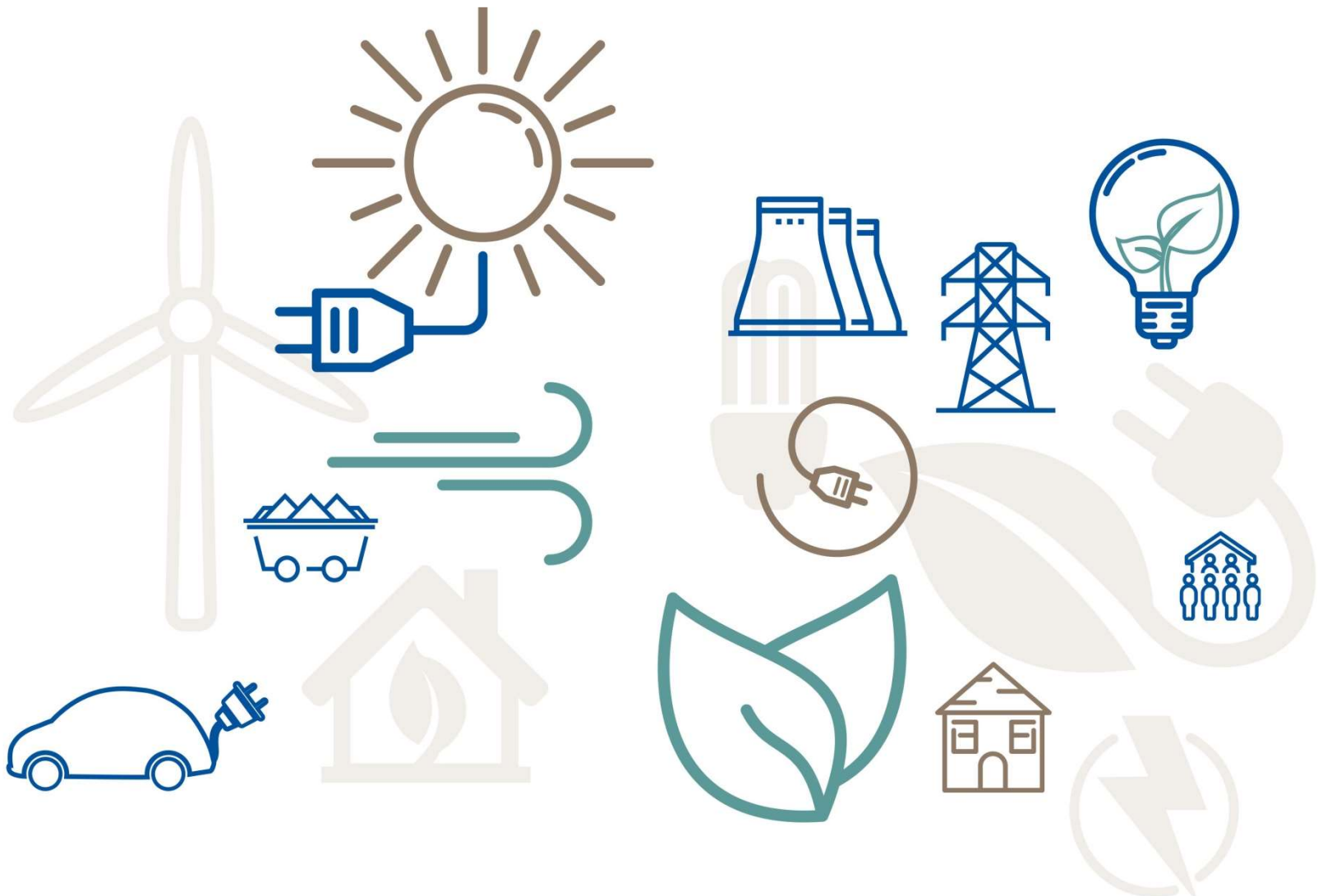


Eskom Group Brief to Standing Committee on Appropriations



10 September 2019

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1.	2015 Eskom Special Appropriation Amendment Bill and 2015 Eskom Subordinated Loan Special Appropriation Amendment Bill: Financial impact of support
2.	State of business: the case for change
3.	Why the R20.7bn loss
4.	Eskom Turnaround Strategy and current status
	4.1 Financial
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	4.1.2 Revenue management and cost initiatives
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I. 2015 Eskom Subordinated Loan: Financial impact of support



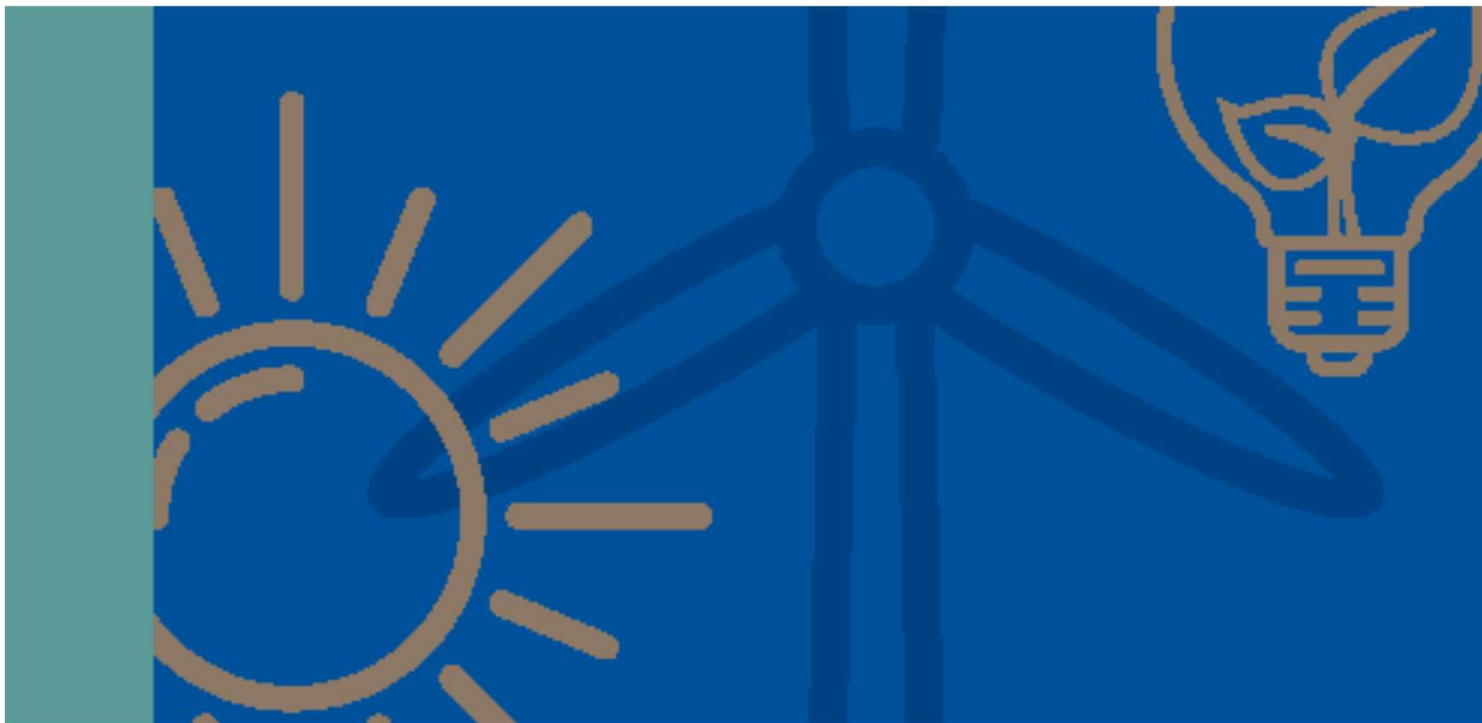
Financial impact of support



- The equity injection of R23 billion in 2015 and the conversion of the subordinated loan of R60 billion had an immediate impact on key ratios with debt / equity improving and a reduction in debt
- The table below reflects the major key ratios before and after the support:

	March 2016	March 2015
Interest cover ratio	0.46	0.25
Gross debt / EBITDA ratio	12.24	16.49
Debt / equity	1.73	2.70
Debt service cover ratio	1.00	0.82

2. State of business: the case for change



Eskom in its current form is unsustainable



Debt

Debt approaching R450B

Unable to service from own EBITDA

Must borrow to service debt



Revenue

Volume declining 1% per year, not coming back

Tariffs not cost reflective

R38Bn in receivables outstanding



Costs

Opex increased 30% in 5 years, reaching R151B in FY19

Large increases in employee, coal costs and IPP payments



Operations

EAF below 70% during FY19

Load shedding, increased costs, lost revenue, lost credibility



Outdated Business Model

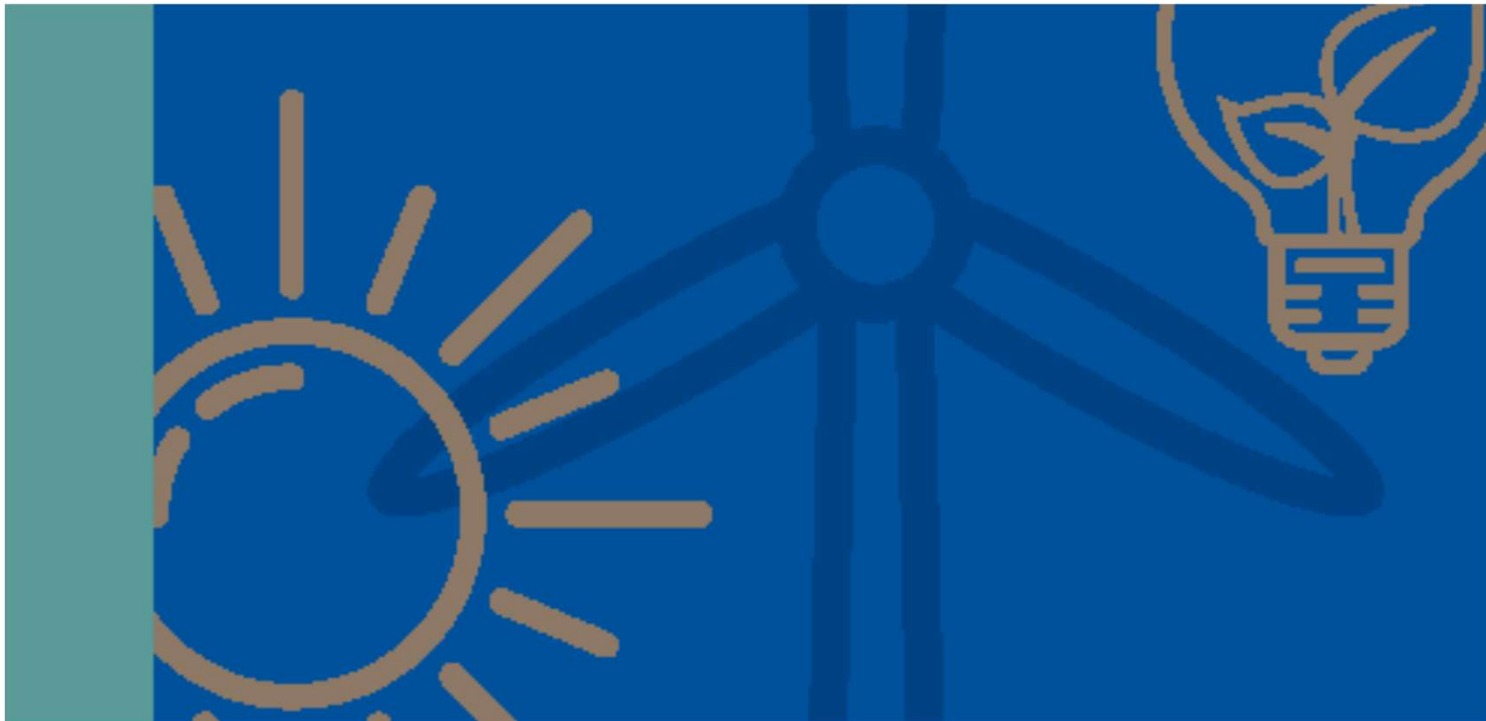
Utility death spiral

Operational and structural inefficiencies

Lack of transparency

Change in energy landscape

3. Why the loss of R20.7 billion?



Decline in EBITDA and net loss recorded



Income statement R billion	March 2019	March 2018	YoY % change
Revenue	180	177	3
Other income	2	1	~
Primary energy	(99)	(85)	(17)
Net employee benefit expenses	(33)	(29)	(13)
Net impairment loss	-	(1)	~
Other expenses	(18)	(18)	-
EBITDA	31	45	(31)
Depreciation and amortisation expenses	(30)	(23)	(29)
Net fair value loss on financial instruments and embedded derivatives	(3)	(2)	~
Net finance cost	(28)	(23)	(19)
Loss before tax	(29)	(3)	~
Income tax	8	-	~
Net loss for the year	(21)	(2)	~

- Revenue: negatively impacted by IFRS 15 and pre-commissioning capitalisation
- Primary energy cost: higher OCGT utilisation, higher coal cost and increased IPP production
- Employee benefit cost increased: wage settlement of bargaining employees
- Depreciation growth: commissioning of new power station units and accelerated depreciation on Komati
- Finance costs: growth in borrowings

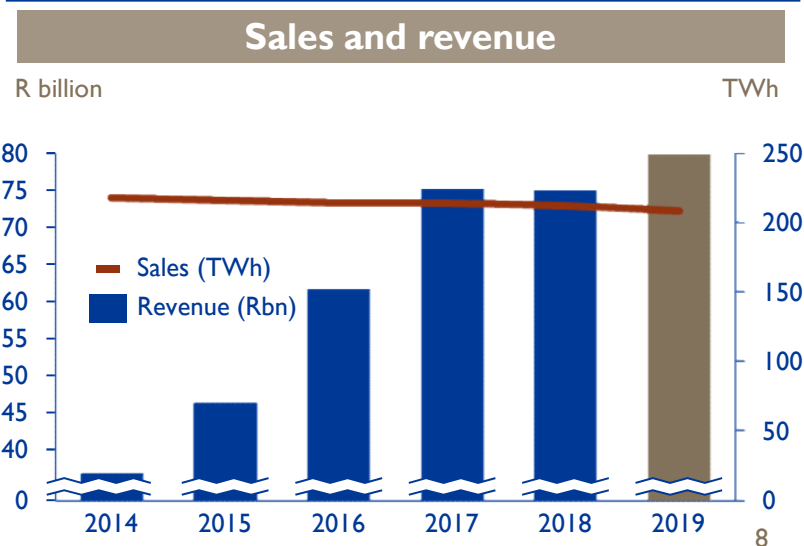
Revenue before IFRS adjustments increased by 4%



	March 2019	March 2018	% Growth
Revenue, R billion			
Local	179	171	5
International	8	10	(14)
Total billed revenue	187	180	4
IFRS adjustment	(7)	(3)	
Total revenue	180	177	3

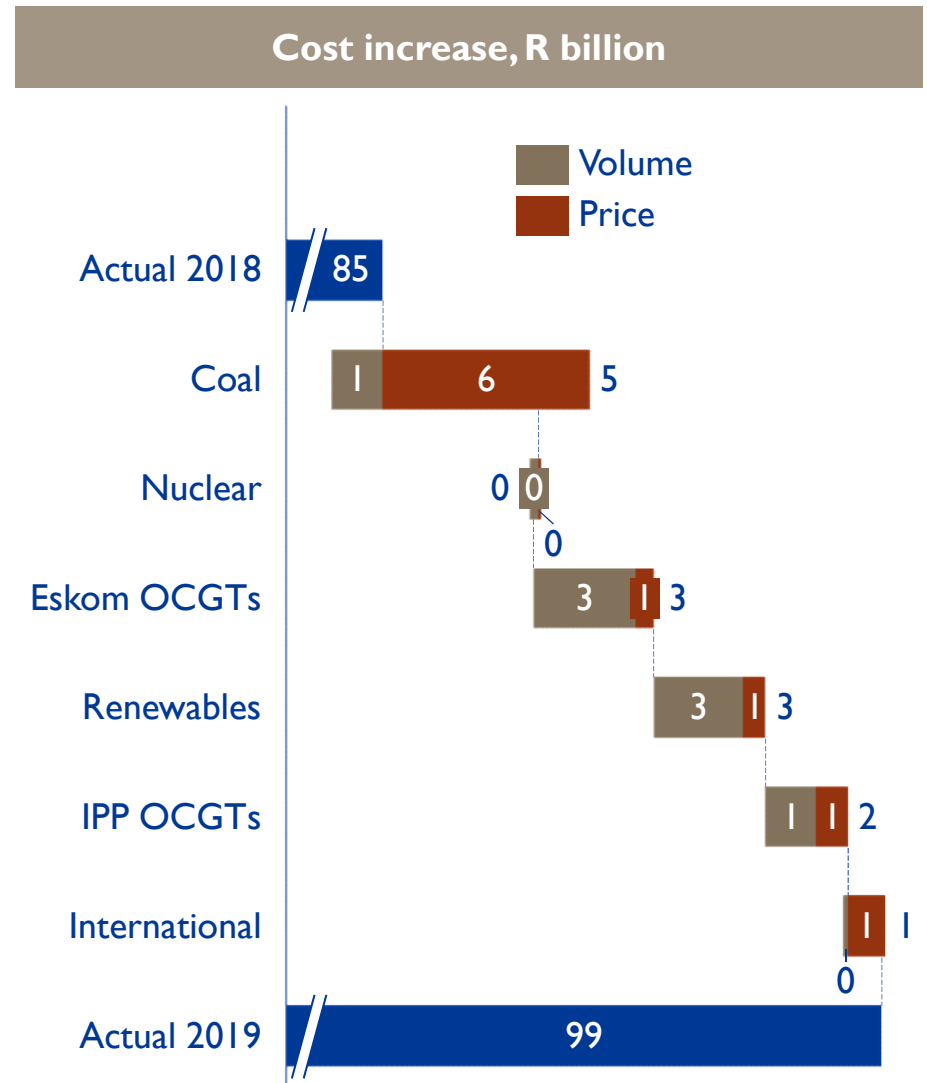
Sales, TWh			
Local	196	197	(0.5)
International	12	15	(18.4)
Total sales	208	212	(1.8)

- Reduction in sales mainly in mining and residential categories
- Other categories remain stable
- International sales reduced
- Average price increase of 5.8%, from 85c/kWh to 90c/kWh
- Volume variance – (R3 billion); price variance R7 billion
- IFRS 15 applies cash basis for defaulting customers, negatively impacting revenue



Primary energy cost increased by 17%

- Eskom production volume reduced and renewable IPP production volume increased
- Total (Eskom and IPP) OCGT cost of R6.5 billion, an increase of R5.9 billion
- Renewable IPPs is 4.8% of total production and 22% of total cost
- Eskom total cost increased by R7.8 billion
- Renewable IPP cost increased by R3.2 billion and IPP OCGTs by R2.4 billion

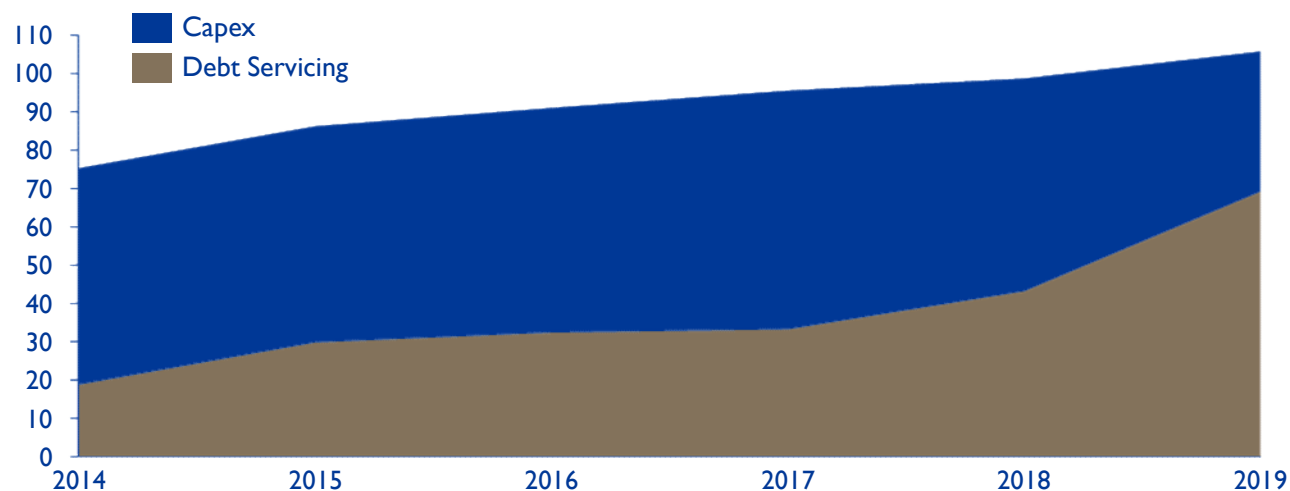


Cash from operations not sufficient to service debt



Cash flow statement, R billion	March 2019	March 2018	YoY % change
Net cash from operating activities	33	38	(13)
Cash required for debt servicing	(69)	(44)	(60)
Net cash movement before investment activities	(36)	(7)	~
Cash flow used in investment activities	(36)	(55)	35
Cash flow from financing activities	58	58	~
Net decrease in cash and cash equivalents	(14)	(4)	~

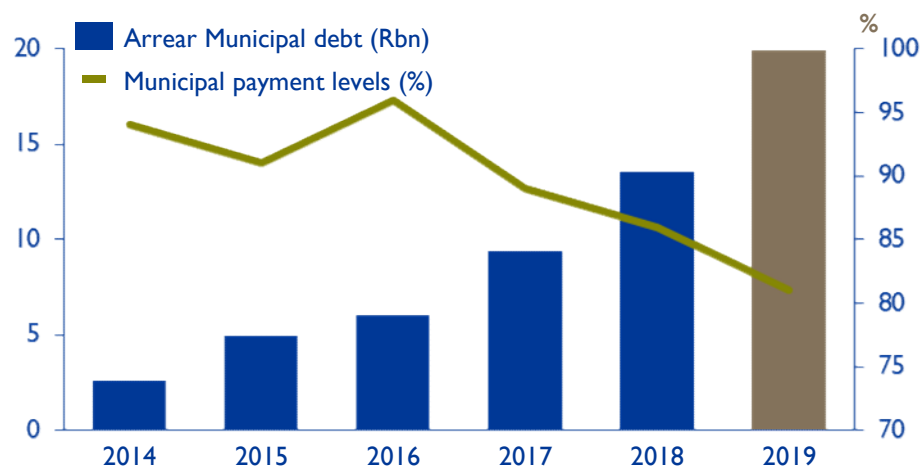
Substantial increase in cash required for debt servicing, R billion



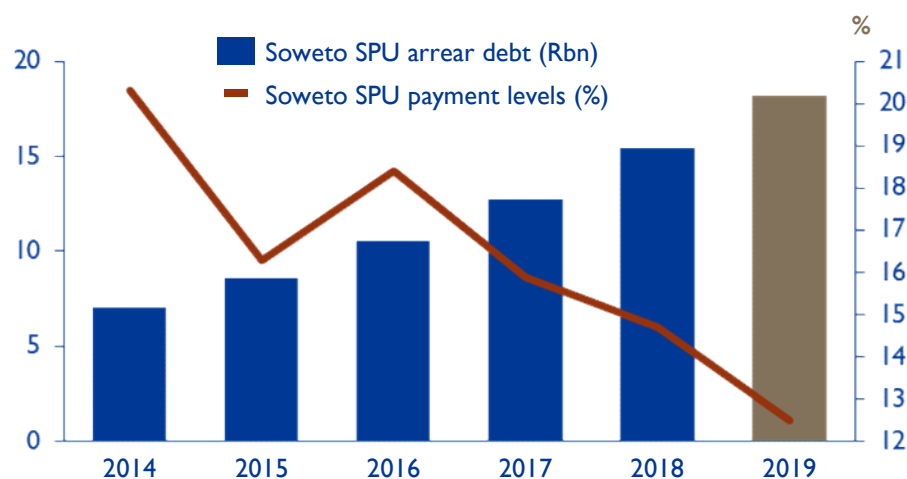
Municipality and Soweto debt increase



Invoiced municipal arrear debt, R billion



Soweto small power user (SPU) debt, R billion



- Invoiced municipal arrear debt (including interest) increased by R6.3 billion, to R19.9 billion Current payment level of 81% by municipalities (excluding metros) Invoiced Soweto SPU arrear debt (including interest) increased to R18 billion (2018: R15 billion); payment level of 12.5%

- Other overdue debt amounting to R2.5 billion, including R0.8 billion for international customers

- Working with Inter-Ministerial Task Team to address municipal debt

- Liaising with communities in Soweto to address the non-payment culture; legal action taken against customers

Price of electricity not sufficient to recover prudent and efficient costs

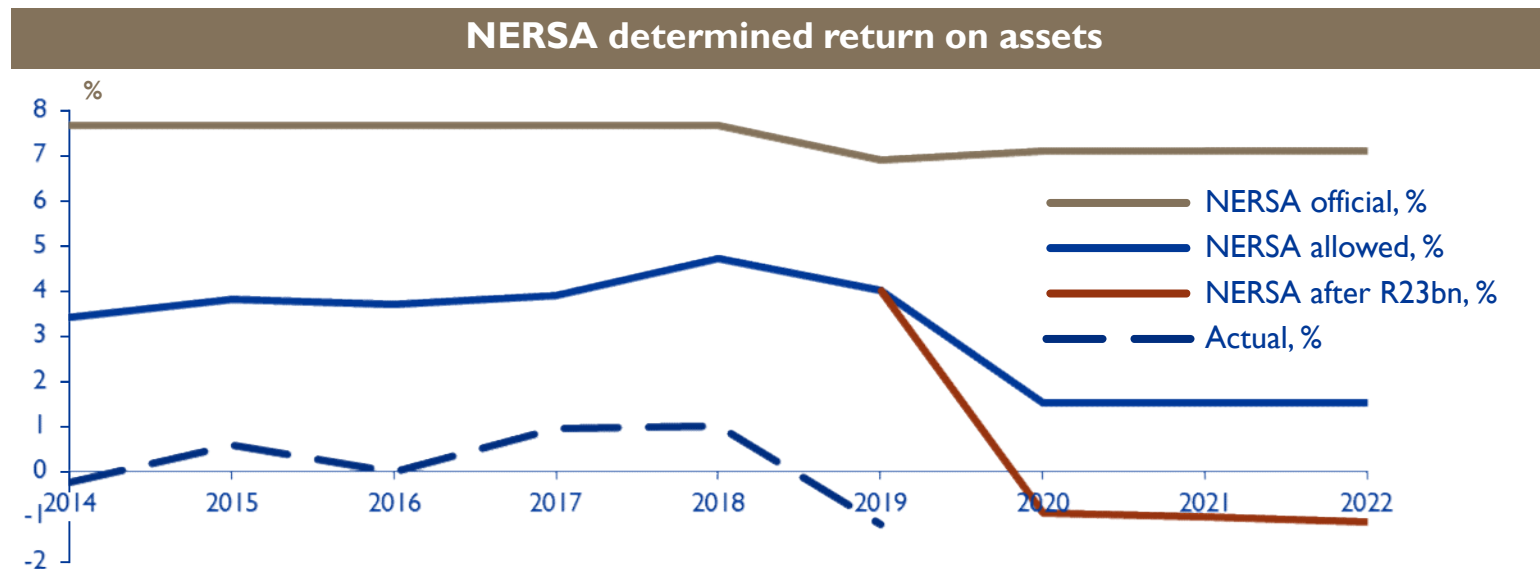


- Eskom has three sources of funds; revenue, borrowings and shareholder support
- Ideally, revenue should be sufficient to redeem the capital over the asset life time and cover the interest cost
- Debt funding exceeding R440 billion, reaching limits
- Eskom has not recovered its prudent and efficient costs and a fair return for many years, as determined by the Electricity Pricing Policy
- The only short-term option is shareholder support
- Cost savings alone will not solve Eskom's financial health
- The only long-term solution is for the electricity price to migrate to cost reflectivity

Price of electricity not sufficient to recover prudent and efficient costs



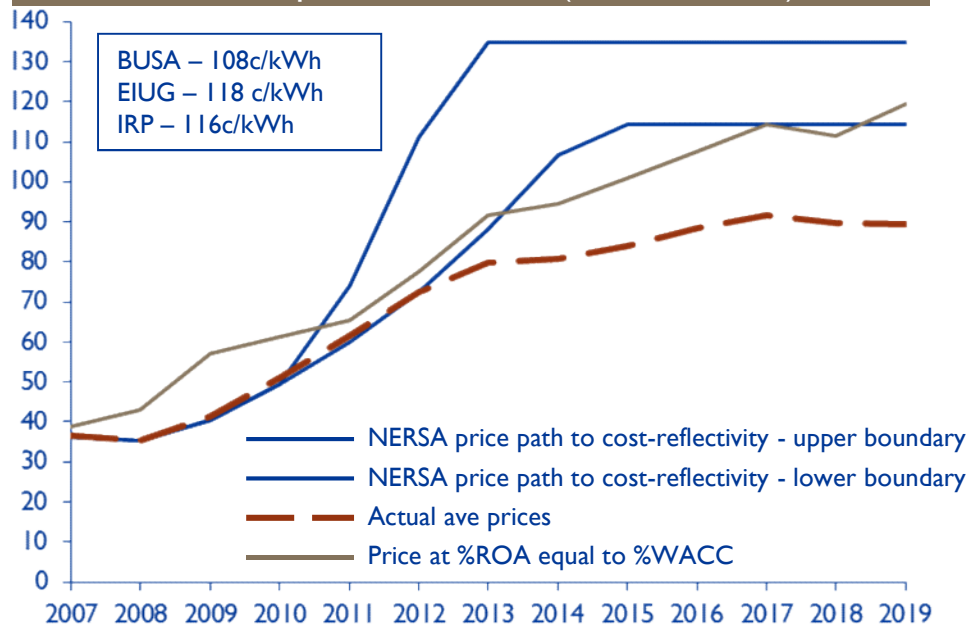
- The return on assets should at least be equal Eskom's weighted average cost of capital (WACC)
- The historic return allowed by NERSA has been far less than the WACC determined by NERSA
- In the MYPD4 determination NERSA allowed a 1.5% return on assets while the WACC determined by NERSA is 7.1% (pre-tax, real)
- NERSA has further reduce the return with the R23bn p.a. government support resulting in a negative return, thereby eroding Eskom's liquidity and financial position
- Even the 7.1% is low and Eskom's calculation reflects a much higher WACC – a private entity would require a much higher return on assets



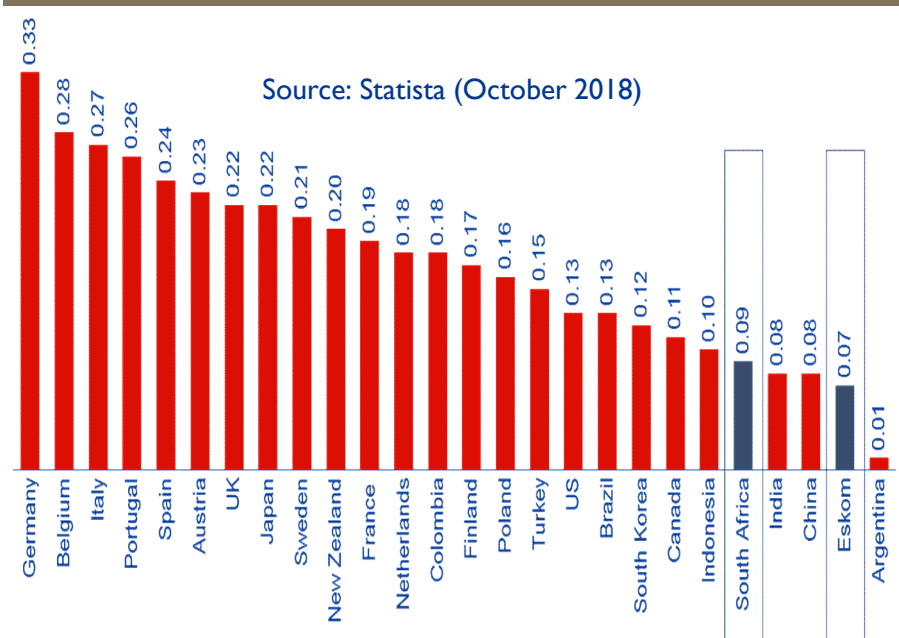
Rapid increase in price of electricity, but still not cost reflective and still low-priced



Price comparison – c/kWh (constant 2019)

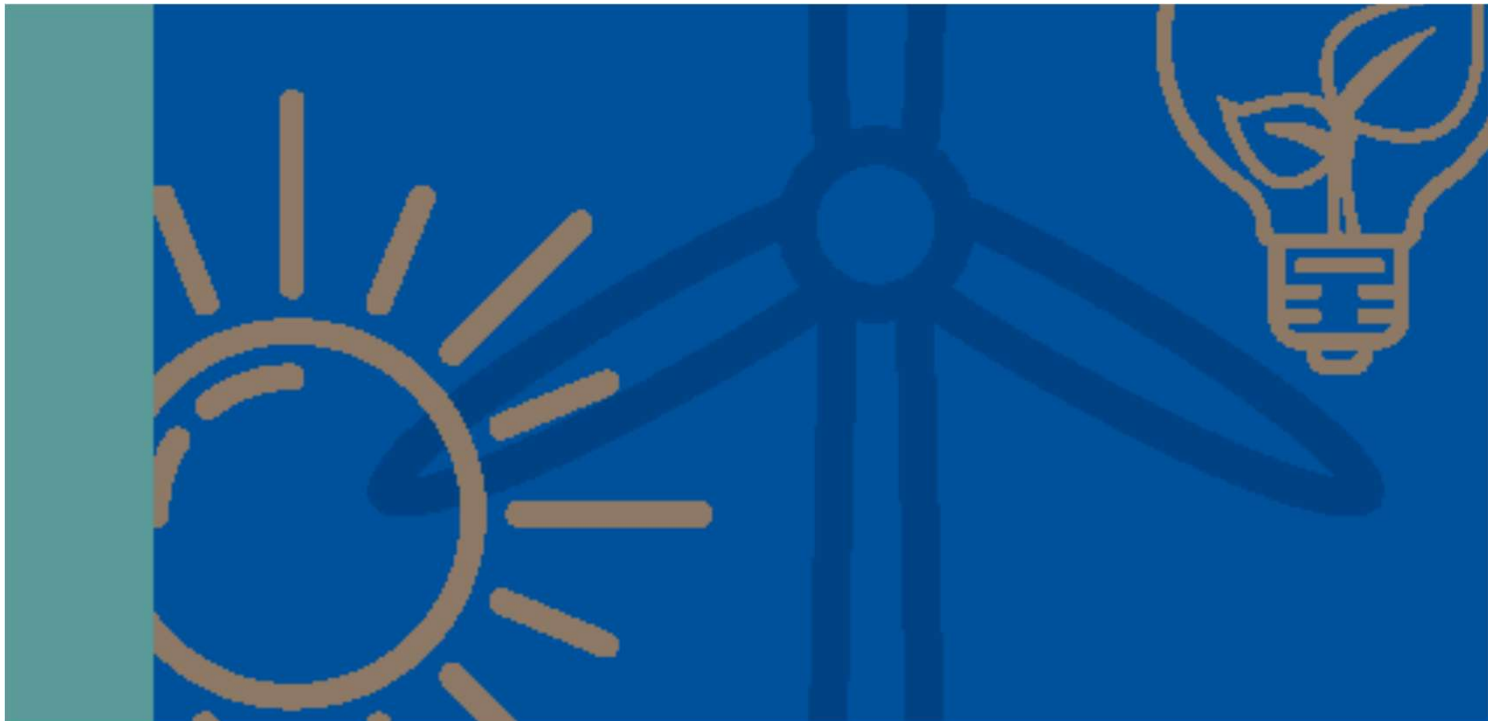


Recent international tariff benchmark – US c/kWh



- Various studies confirmed that Eskom's price is below efficient and prudent cost reflectiveness
- Up to this point Eskom's balance sheet has subsidised the consumer
- The current reality is that this is no longer possible as reflected in the negative financial results
- Government support is now required to subsidise the consumer
- Alternatively, the price must immediately migrate to prudent cost reflectivity

4. Turnaround strategy



Eskom Strategy in a nutshell...



STRATEGY TO A NEW ESKOM

Vision: Drive economic growth by being a financially stable provider of energy solutions across Africa

Stabilise

1

Separate

2

Grow

3

TURNAROUND PLAN

Debt relief

Revenue
Management

Cost initiatives

Business
separation

Operational
stability

HIGH PERFORMANCE CULTURE

ADVOCACY AND STAKEHOLDER ENGAGEMENT

CO-CREATING AN INDUSTRY AND MARKET STRUCTURE

STABILISE

- Improved governance
- Improved profitability -R79.3bn EBITDA
- Improve electricity reliability-EAF 78%
- Cost reflective tariff path
- Retain existing customers
- Cumulative savings R77bn
- Debt Relief
- Improved receivables

GROW

- Lower carbon energy mix
- Renewables player
- E-mobility
- Storage
- Micro and mini-grids
- New electricity customers
- Smart grids expansion

We have developed a turnaround plan centered on 5 focus areas

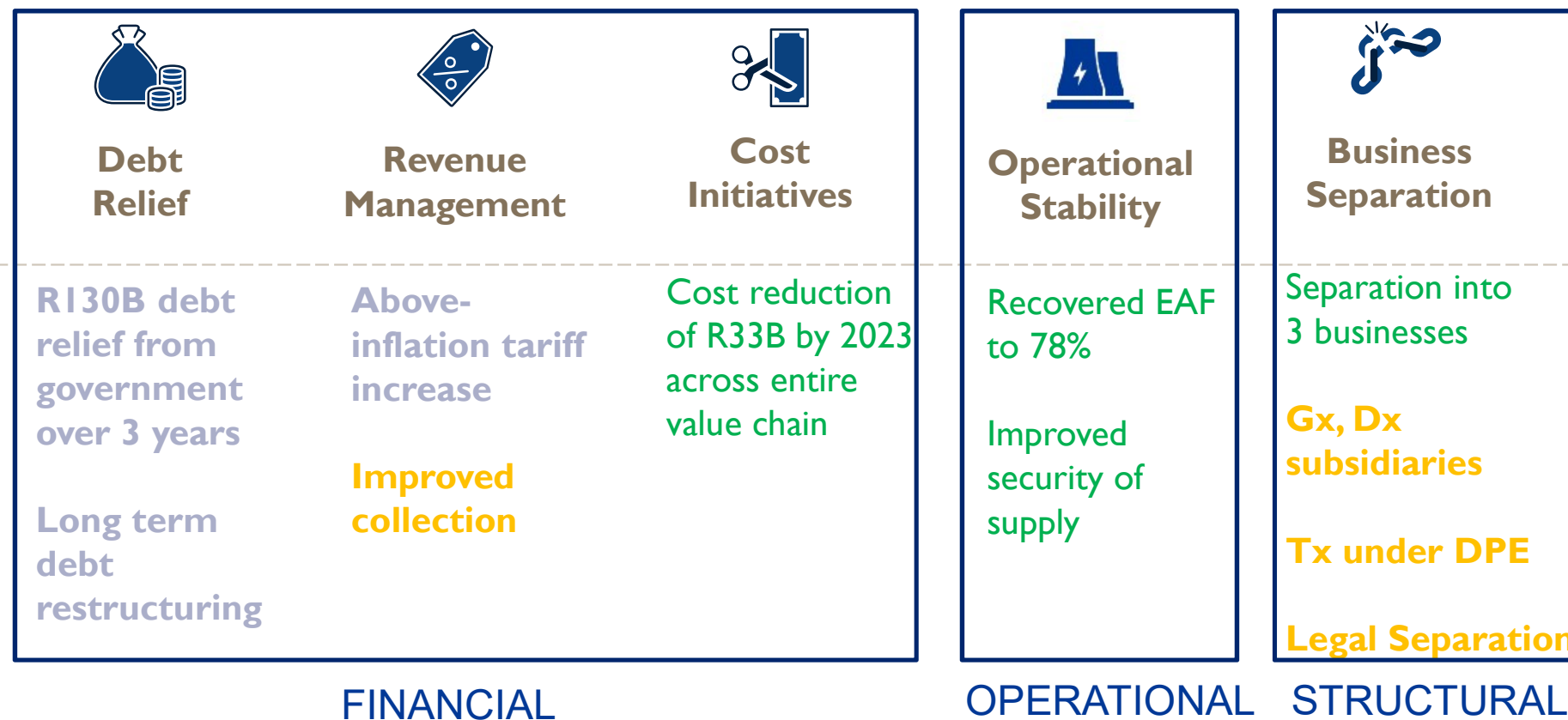


RESPONSIBILITY

ESKOM

GOVERNMENT

ESKOM AND GOVERNMENT



4. Turnaround Strategy

4.1 FINANCIAL

4.1.1 Debt Support



- Eskom sustainable debt stock should be 5 times EBITDA.
- With a R40 billion EBITDA, Eskom can sustain R200 billion requiring a R250 billion removed off Eskom's balance sheet by a debt transfer to government.
- Debt levels to be maintained by ensuring future Capex spend equals Redemption amounts
 - Both Medupi and Kusile to be completed within 5 years
 - Offset by Capex required for partial environmental compliance of 57%

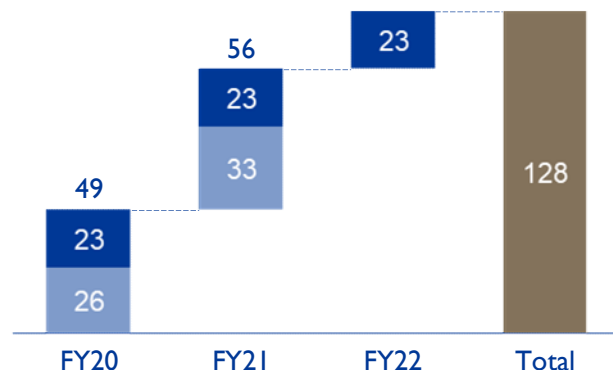


Government Debt Support



Debt support secured from government

Rbn



Government Debt Support- the CRO will be responsible for this process

The CRO will be the single point of contact with the financial community to give assurance on the process with regards to the debt.

The CRO areas of responsibility include:

- Liaising and negotiating with debt holders on plans and progress
- Liaising with rating agencies on plans and progress
- Formal liaison with government on the plan, approvals and progress
- Formal liaison with the Eskom Board on plans and progress
- In carrying out his tasks he will:
 - Prepare a framework
 - Develop a financial model and analyse options
 - Develop and finalise blue print for debt and organisational restructuring
 - Implement debt allocation

4. Turnaround Strategy

4.1 FINANCIAL:

4.1.2 Revenue management and cost initiatives



Eskom is pursuing financial stability and sustainability through focus on cost, debt and revenue



Outside of Eskom's control

In Eskom's control

Revenue Growth

Revenue Growth

- Drive short-term growth with pricing incentives
- Grow international sales
- Pursue new growth opportunities

Cost Containment

Cost efficiency

- Drive procurement excellence
- Reduce sundry expenses
- Launch operational improvements:
 - Generation
 - Distribution
 - Transmission
- Improve ERI operational performance (if not sold)

Primary Energy

- Reduce road & rail logistics costs
- Optimize coal inventory

Operating model Optimisation

- Reduce overtime

Balance sheet sustainability

- Rebalance commercial/social mandate
- Obtain tariff increase (NERSA)
- Efficient IPP pricing
- Sell non-core assets and selected core assets
- Get debt relief from State and/or Monetize municipal debt and/or State production/consumption subsidy
- Enter a strategic equity partnership

4. Turnaround Strategy

4.3 OPERATIONAL: Operational stability



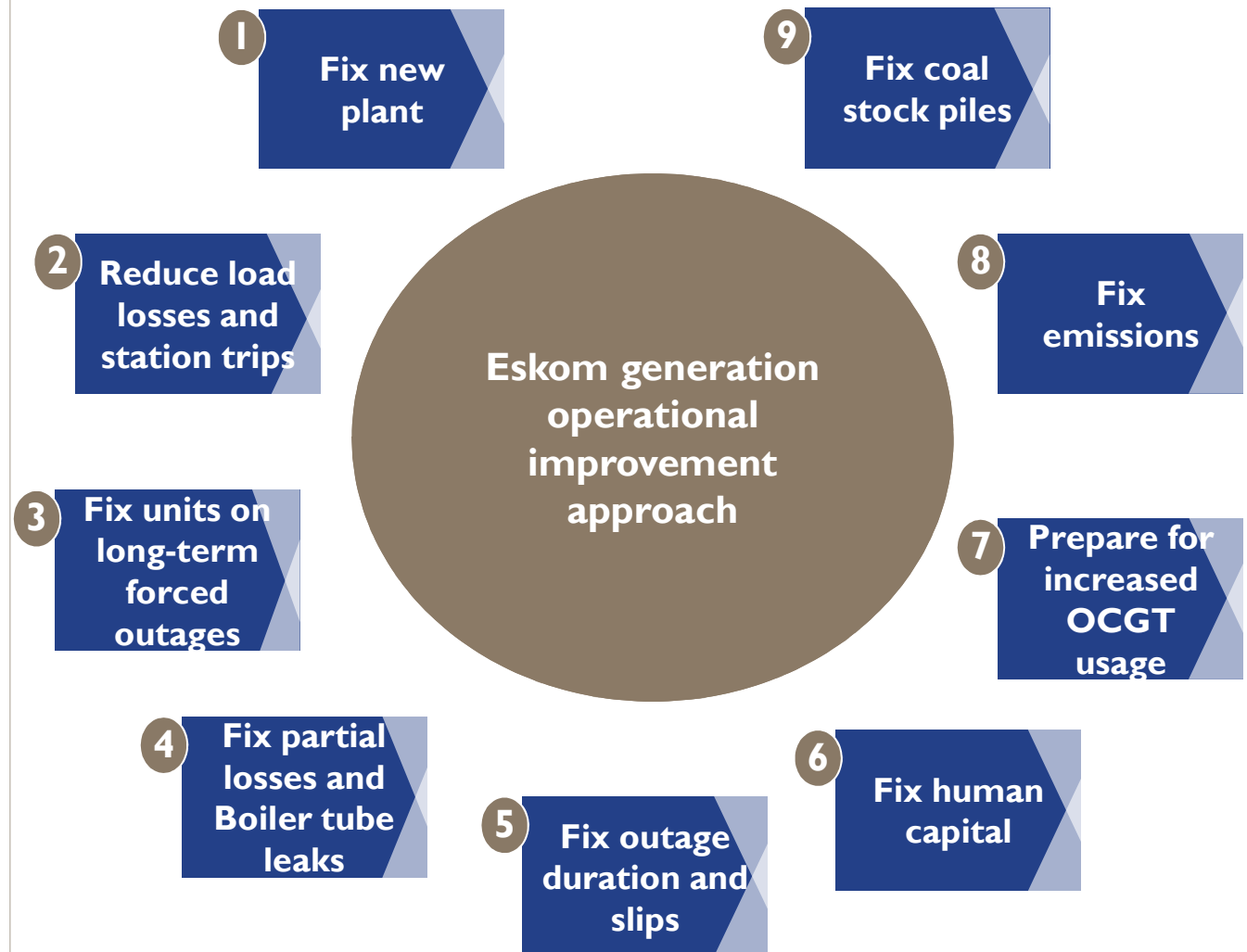
Eskom is focusing on Operational Stability and Sustainability



Focus:

- Eskom is currently **focussing on generation** due to the its **importance in achieving operational stability**
- Eskom's focus is also on Tx and Dx sustainability (specifically on the **health of the Tx and Dx infrastructure**)
- Implementation of the Gx longterm sustainability strategy will follow the 9-point plan

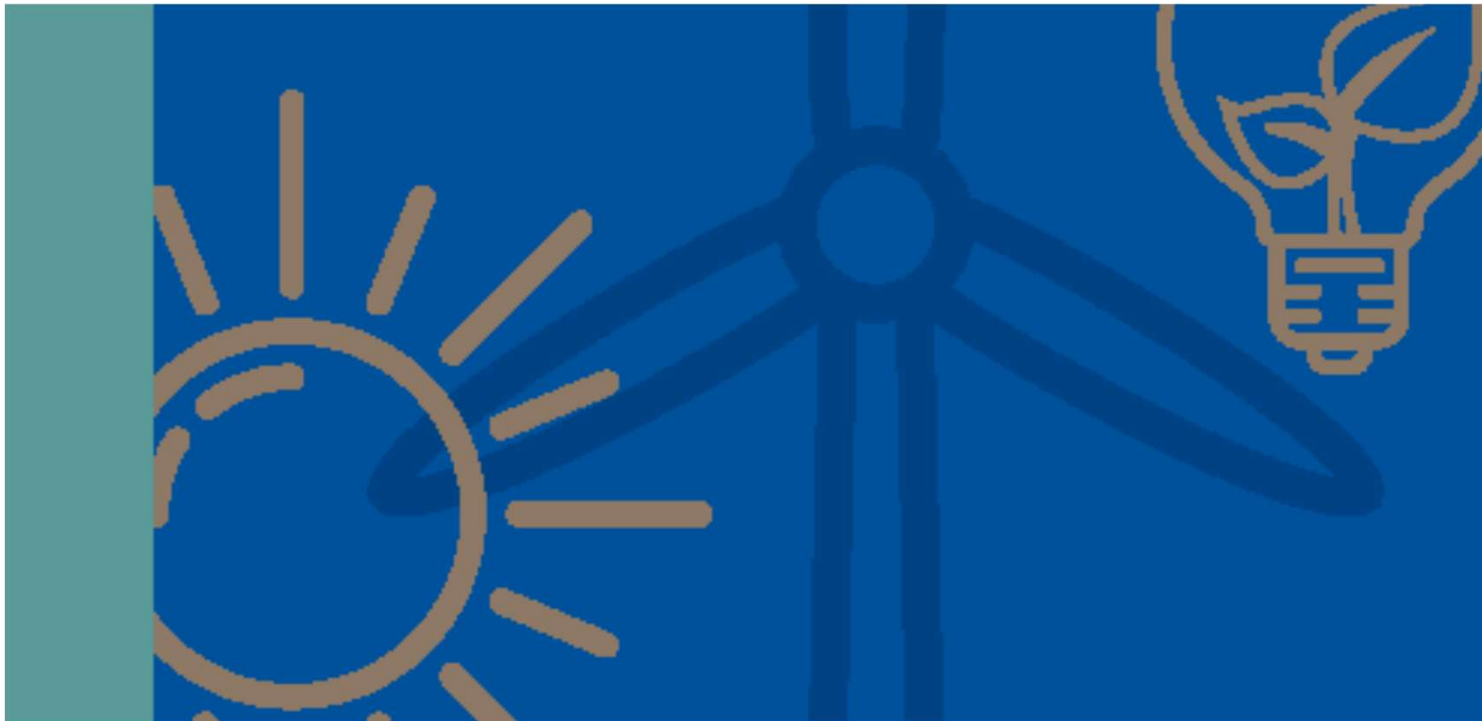
Generation Sustainability- 9- Point Plan over 2 years: 2018/2019



9 Point Generation plan progress

- Although the plan is in initial stage excellent results have been achieved, as follows:
 - 157 days (on Wednesday 28 August 2019) without the need for load shedding
 - Good progress made in improving plant performance at Medupi, Kusile and Ingula, with Ingula now operating at almost full capacity
 - Work has started to repair the high-pressure pipework at Lethabo Power Station and is planned to be returned to service in December 2019.
 - Good progress in filling critical vacancies including appointment of Generation Group Executive
 - Reduced reliance on OCGTs with usage well below budget
 - Good progress in replenishing coal stock days with the overall stock days at 49.4 days in mid August and only 2 stations below 20 days
- The focus now is to ensure that we meet the summer demand

5. 2015 Eskom Subordinated Loan: Progress on conditions of support



Eskom compliance to conditions of the R23bn government equity injection and R60bn loan conversion



● Fully compliant
 ● Partially compliant
 ● Condition closed
 ● Additional reporting requirement

Condition	NT status	Eskom status	Eskom update
<ul style="list-style-type: none"> Eskom must provide a comprehensive maintenance strategy for the next three years and implementation plan for the next 12 months aimed at improving the energy availability factor (EAF) and reducing unplanned outages and partial load losses 	●	●	<ul style="list-style-type: none"> Reported on a quarterly basis.
<ul style="list-style-type: none"> Eskom must implement the planned maintenance in line with the maintenance strategy and implementation plan 	●	●	<ul style="list-style-type: none"> Report on a quarterly basis. Q4 – March 2018 Shareholder's Quarterly Report
<ul style="list-style-type: none"> Deliver at least R60 billion of savings through the cost-saving programme as encapsulated in the 2015 Corporate Plan and strive to achieve additional savings 	●	●	<ul style="list-style-type: none"> Reported on a quarterly basis. Q4 – March 2018 Shareholder's Quarterly Report reflected final results.
<ul style="list-style-type: none"> Submit applications to the National Energy Regulator of South Africa (NERSA) for tariff adjustments in line with regulatory processes 	●	●	<ul style="list-style-type: none"> Regulatory update provided quarterly in the Shareholder's Quarterly Report
<ul style="list-style-type: none"> In addition to the R200 billion of debt that Eskom had planned to raise during the third multi-year price determination (MYPD3) period, Eskom must raise an additional R52 billion of debt 	●	●	<ul style="list-style-type: none"> No further requirements
<ul style="list-style-type: none"> In line with the budget allocated in the 2015 Corporate Plan, connect Renewable Energy Independent Power Producers (REIPPs) to the national grid in line with the REIPP programme 	●	●	<ul style="list-style-type: none"> No further requirements

Eskom compliance to conditions of the R23bn government equity injection and R60bn loan conversion



Fully compliant

Partially compliant

Condition closed

Additional reporting requirement

Condition	NT status	Eskom status	Eskom update
<ul style="list-style-type: none"> Not undertake investments in <u>future</u> coal mines 			<ul style="list-style-type: none"> No further requirements
<ul style="list-style-type: none"> Implement the R250 billion capital expenditure programme together with the additional R29 billion for critical transmission and distribution infrastructure as presented to government in August 2014 which formed the basis for the approved GSP. 			<ul style="list-style-type: none"> No further requirements
<ul style="list-style-type: none"> Limit cost-overruns in the new build programme 			<ul style="list-style-type: none"> No further requirement
<ul style="list-style-type: none"> Submit alternative proposals to government for consideration should deviations be required 			<ul style="list-style-type: none"> No further requirement
<ul style="list-style-type: none"> Eskom must submit a detailed proposal for the disposal of non-core assets to be executed before the end of the MYPD3 period 			<ul style="list-style-type: none"> EFC and non-core property identified Challenges to dispose of EFC as a going concern. IFC approved the disposal of loan book. Target date March 2020.
<ul style="list-style-type: none"> Eskom must undertake a review of labour costs, employee benefits and salary adjustments and take steps to address the findings from the review 			<ul style="list-style-type: none"> The report was submitted to National Treasury and DPE. MoF confirmed in a letter dated 6 Nov 2017 that all conditions have been closed. There were queries which arose, and these have been addressed between Eskom, DPE and NT officials. The only outstanding query relates to contracting an independent service provider to conduct further review on manpower costs escalations. This query has been set aside as Eskom's cost savings plan includes addressing manpower costs.

Eskom compliance to conditions of the R23bn government equity injection and R60bn loan conversion



● Fully compliant
 ● Partially compliant
 ● Condition closed
 ● Additional reporting requirement

Condition	NT status	Eskom status	Eskom update
<ul style="list-style-type: none"> Eskom must commission an independent review of its operating model, including its subsidiaries, to improve efficiency; submit the findings from the review to NT and DPE within 18 months; and take steps to address the findings from the review 	●	●	<ul style="list-style-type: none"> The Operating Model review was done by PWC and has been shared and discussed with both DPE and NT. Letter from MoF (6Nov'17) confirmed all conditions are closed. The results was incorporated in the Corporate Plan
<ul style="list-style-type: none"> Eskom must ensure that the investigations initiated by the Board are concluded within the contracted timelines; submit the findings from the review to the Ministers of Finance and Public Enterprises; and take all appropriate actions based on the outcome of the investigations 	●	●	<ul style="list-style-type: none"> No further requirement per the conditions
<ul style="list-style-type: none"> Eskom must fill vacant executive management positions as a matter of priority 	●	●	<ul style="list-style-type: none"> No further requirement per the conditions
<ul style="list-style-type: none"> Eskom must provide quarterly progress reports to NT and DPE in line with the reporting framework that will be stipulated by NT and DPE. This may include requirements for Eskom to have achievements independently verified 	●	●	<ul style="list-style-type: none"> Quarterly reports were submitted Q4 – March 2018 Shareholder's Quarterly Report
<ul style="list-style-type: none"> Eskom must undertake to adhere to these conditions for the remainder of the MYPD3 period for which Eskom requested financial support 	●	●	<ul style="list-style-type: none"> Information continuously reported until the 31 March 2018 – end of MYPD3