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DEPARTMENT OF PUBLIC ENTERPRISES: CHALLENGES FACING STATE OWNED COMPANIES (SOCs)

1. INTRODUCTION

This paper aims to give a brief overview of the challenges faced by the State Owned Companies (SOCs) as well as the Department of Public Enterprises (DPE). Furthermore, this brief aims to provide Members of the Portfolio Committee on Public Enterprises with information on the issues emanating from each SOC as well as the Department itself, in preparation for the meeting with the DPE scheduled for 3 February 2021.

Some of the issues highlighted relate to the Department of Public Enterprises concerning the Government Shareholder Management Bill; Eskom progress on its turnaround strategy; Denel turnaround strategy; South African Airways (SAA) business rescue and restructuring; South African Express Airways provisional liquidation and sale; Alexkor administration; and the outstanding annual reports and financial statements of Alexkor, Denel and Safcol. The above issues have also been impacted by the lockdown implemented by the Government in response to the COVID-19 pandemic which occurred from 27 March 2020. These and others are discussed below.

2. DEPARTMENT OF PUBLIC ENTERPRISES

The major outstanding issue with regards to the Department was the development of the Government Shareholder Management Bill, which was to be adopted into law by 2020/21, as stated in the 2019/20 Annual Performance Plan (APP). However, the responsibility for the development of the overarching Act governing SOEs has been given to the Presidential State-Owned Enterprises Council (PSEC). The Council has the mandate to develop the overarching Act and to determine an appropriate Government Shareholder Ownership Model. The Department as a shareholder representative for Government with oversight responsibility for SOEs will provide secretariat support to the PSEC.[1]

Although the Department received an unqualified audit report, the Auditor-General did raise a matter of emphasis. The Department should aim for a clean audit in the 2020/21 financial year.

Further matters are addressed in the Budgetary Review and Recommendations Report (BRRR) dated 18 November 2020. The Department to provide regular updates on the progress made in addressing the BRRR's recommendations. See attached Annexure A page 11 on the recommendations made in the 2020 BRRR.

Issues for Consideration

[1] DPE (2020) Annual Report 2019/20 pg24

The Department's under expenditure of R36 million for the 2019/20 financial year related mostly to the under expenditure on compensation of employees of R21 million. The Department should ensure that all vacancies are filled timeously to enhance the Department's oversight capabilities.

In his foreword in the 2019/20 Annual Report, the Accounting Officer, Mr. Kgathatso Tlhakudi, states that, "To ensure that the current SOCs' performance trajectory is improved, the DPE has tabled a new strategy framed to support the reform of the SOCs in line with the institutional plans as outlined in the 2019-2024 Medium Term Strategic Framework (MTSF)."[2] When was the new Strategic Plan submitted to Parliament? The Department should provide the Committee with an overview of the new strategy the Department wants to implement.

3. ESKOM

Eskom's Acting Treasurer Mandla Maleka has stated that during the lockdown, due to the COVID-19 global pandemic, Eskom is expecting revenue losses in the region of R2 billion to R2.5 billion a month. This is due to the reduced demand in electricity by intensive users. Although, the financial impact on March 2020 is expected to be small, as only five days of lockdown were recorded for the month, the impact of April will register in the interim results for six months to September 2020, and in the full year ending March 2021. Maleka further stated that the company would look into its cost structures and investigate programmes that may help reduce costs and offset the revenue losses.[3]

As at the end of the 2019/20 financial year, the company recorded a R20.5 billion loss for the year. The company's total debt was R483 billion, which is backed by government guarantees.[4] To stabilise the company's financial position in the short term, an additional R33 billion was allocated to the company in 2020/21 through the Special Appropriations Act (2019) in addition to the provisional allocation of R23 billion. These allocations are subject to conditions set by the National Treasury, which include updates on strategies to manage municipal and other consumer debts, coal contract renegotiations and cost containment measures.[5] Municipal debt increased by R4.9 billion from March 2020 to September 2020, to R32.9 billion.[6]

The positive outcome from the lockdown is that it has allowed Eskom space to accelerate its maintenance programme without taking units off line, which constrains capacity and leads to loadshedding. However, according to economists, the expected revenue loss is small compared to the cost of running diesel generators each time there is a maintenance related breakdown on the plant.[7]

[2] Ibid
[3] Khumalo (2020)
[4] Eskom (2020a) Annual Report 2019/20
[5] National Treasury (2020) Estimates of National Expenditure 2019/20
[6] Eskom (2020b)
[7] Khumalo (2020)

Energy analysts said that while the current decline in demand greatly helped Eskom, it had allowed for only low-level and routine repairs. Lockdowns in countries that make boilers, turbines and controls systems – essential for power plants – mean Eskom has battled to secure vital components especially for its Medupi and Kusile power plants. Bottlenecks at ports have added to the delays. The global lockdowns have also prevented Eskom from bringing in specialised engineers to work on the equipment. Eskom's spokesperson, Mr. Sikonathi Mantshantsha agreed with this view saying the maintenance that had been done would not make a huge difference to supply. Eskom's Head of Power Generation, Mr. Bheki Nxumalo, stated that power cuts were "most likely to resume not long after the national lockdown is lifted during May" and continue until August 2021. Loadshedding will most likely resume as demand for electricity will rise more or less to the same levels it was before the lockdown. Mr. Nxumalo stated that only when the design defects at the Medupi and Kusile power stations have been corrected are we most likely to see the end of loadshedding.[8]

At the State of the Power System presentation dated 31 January 2020, the Chief Executive Officer (CEO) of Eskom, Mr. Andre De Ruyter, stated that restructuring of the entity was underway as approved by Government into three business entities. He mentioned that the boards of these three entities, Generation, Transmission, and Distribution were in process of being appointed, which would provide the company with better accountability. Further to this, at the interim results of the entity presented on 14 December 2020, the entity advised that the divisionalisation of the three entities was completed by March 2020, with the functional separation to be completed by March 2021. The separate Transmission subsidiary is still being targeted by December 2021, with Generation and Distribution by December 2022.[9]

South Africans are currently experiencing intermittent loadshedding at Stage 2, due to the unavailability of certain units. The loadshedding which took place for the period 14 to 17 January 2021, Eskom stated that this was due to loss of generation capacity as well as to manage the use of the emergency reserves, which helps contain the stage of loadshedding required. Two generation units at the Kusile Power Station tripped due to the failure of the main coal feed conveyor belts supplying coal to the units. In addition, a unit each at the Kriel and Duvha tripped due to unforeseen breakdowns. Eskom also had four generation units whose return to service from planned maintenance was delayed. At that time Eskom had 5 358 megawatts (MW) on planned maintenance, while another 14 748MW of capacity was unavailable due to unplanned maintenance, breakdowns and the outage delays as mentioned.[10] As stated above, the utility stated that loadshedding should be expected until August 2021.

Issues for Consideration

[8] Hosken (2020)
[9] Eskom (2020b)
[10] Eskom (2021)

By the 09 December 2020, Eskom had lost 34 employees and three contractors to the COVID-19 virus.[11] How is the entity ensuring the safety of its employees as they return to work amid the global COVID-19 pandemic?

As at 30 September 2020, the entity showed a net profit of R83 million.[12] However, given that the country was placed on Adjusted Level 3 lockdown in January 2021, how will this impact on its financial performance for the 2020/21 financial year?

The entity should update the Committee on the progress of correcting the defects on the Medupi and Kusile power plants.

Unplanned breakdowns and outages are still high. How is the entity addressing the high level of unplanned breakdowns? How has the maintenance plan been affected by the national lockdown and the acquisition of parts?

4. SOUTH AFRICAN AIRWAYS (SAA)

SAA was placed under voluntary business rescue in December 2019. A business rescue plan was to be in place by the end of March 2020, however, an extension was granted to the business rescue practitioners to submit the plan later.

In the medium-term budget, Minister of Finance, Mr. Mboweni, confirmed that SAA will get the R10.5 billion as outlined in its business rescue programme. The Minister stated that the funds should not be considered a bailout as the funds allocated will help the airline meet its financial obligations and assist in finding private investors.

The Business Rescue Plan, concluded in line with section 151 of the Companies' Act, has made the following recommendations:

- A payment of a compromise dividend to the Company's concurrent creditors of R600 million which would equate to approximately 7,5 (seven and a half) cents in the Rand) and payable over a three-years period;
- A payment of approximately R1.7 billion to aircraft lessors, which is an equivalent of six months aircraft rental payments, again, payable over a three-year period;
- The Post-commencement creditors will be paid directly out of the working capital injection for the restart of the airline;
- The Lenders, inclusive of PCF lenders, will be paid as contemplated in the budget announced by the Minister of Finance on 26 February 2020; and
- Retrenchments, estimated to cost R2, 2 billion, are contemplated which will result in one thousand employees being retained by the Company and such retrenchments will be pursued

[11] Eskom (2020b)
[12] Eskom (2020b)

through either the Leadership Consultation Forum or section 189 process of the Labour Relations Act.[13]

The R10.5-billion will pave the way for the finalisation of the business rescue process and restructuring of the airline through the following activities:

- Appointment of an Interim Board;
- Appointment of an Interim Chief Executive Officer and Interim Chief Financial Officer;
- Implementation of a Social Plan – a training layoff scheme which will be facilitated by the Transport Education Training Authority in partnership with the Department of Labour and Employment;
- Selection of a suitable Strategic Equity Partner to strengthen the launch of the new airline;
- Settle the airline's legacy debt including voluntary severance packages to employees and
- Begin preparations for the formation of a new customer-centric airline designed to be lean, technology capable, digitally modernised and agile to service all market segments.[14]

As at 24 December 2020, four South African Airways based unions and three non-unionised workers formations have agreed on the payment of deferred salaries to employees. These unions and formations are:

- The South African Transport and Allied Workers Union (SATAWU),
- The National Transport Movement (NTM),
- Solidarity,
- The Aviation Workers Union of South Africa **(**AUSA),
- SAA non-unionised management,
- SAA non-unionised non-management, and
- SAA Wider Management (Union).[15]

The members of these unions and formations will also be paid a lumpsum of the 5.9 per cent increase back dated to April 2020, and their pro rata savings towards a 13th cheque.[16] SAA employees have not received salaries since April 2020.

Currently, the National Union of Metalworkers of South Africa (NUMSA), the SA Cabin Crew Association (SACCA) and the SAA Pilot's Association (SAAPA) have not accepted the offer made. The SAA Business Rescue Practitioners have locked out the members of the union, SAAPA, after protracted negotiations failed to yield agreements on new conditions of employment for a future restructured airline. This means that 383 SAAPA members are not

[13] Ministry of Public Enterprises (2020a)
[14] Ibid.
[15] Ministry of Public Enterprises (2020b)
[16] Ibid.

allowed entry to the airlines' premises and receive no salaries until an agreement is reached. The DPE was fully supportive of the lockout.[17]

The Minister advised Parliament on 23 November 2020 that due to SAA being under business rescue the Auditor-General has suspended the audit. The audit will be finalised once the airline recommences operations and the annual report and annual financial statements will thereafter be tabled.

Issues for Consideration

The Department should update the Committee on the business rescue process. What remains outstanding in the process to finalise the business rescue?

What strategic partners, if any, are being considered for the airline?

The amount of R2 billion that government has set aside as working capital for the airline's restart is considered too little by aviation economist, Dr. Joachim Vermooten, stating that the figures showed that the airline would not be a viable going concern from the start.[18] The Department should advise the Committee if they are discussing additional funding for the restart of the airline.

5. SOUTH AFRICAN EXPRESS AIRWAYS

South African Express (SAX) airways was placed under Business Rescue in February 2020 due to financial pressures that resulted from poor management and state capture. The business rescue practitioners applied to the High Court for the provisional liquidation of the airline as it had run out of funds. The Department had rejected several funding requests by the practitioners of up to R691 million in the form of government guarantees. The High Court placed SA Express under provisional liquidation on 28 April 2020. This means that affected parties – creditors, workers, trade unions, and others – have until 9 June 2020 to forward reasons or show good cause why the court should not order the final liquidation of the airline. This would result in the permanent closure of the airline and 691 job losses.[19]

According to news reports dated October 2020, SA Express employees have been successful in their bid to buy the airline. The bid proposal submitted to the airline's provisional liquidiators, Tshwane Trust, will see the entity's ownership being shared by the DPE, 691 employees, crowd investors and an anchor investor. Under the proposed structure, the workers which formed under Fly SAX Group, will own 25 per cent of the airline, 27 per cent will be owned by the

[17] Robertson (2021)
[18] Ibid.
[19] Mahlaka (2020a)

government or a strategic equity partner and 48 per cent by investors from crowdfunding platform Uprise Africa and an anchor investor.[20]

According to the Fly SAX group it is looking at local and international strategic equity partners who would be interested in buying a stake of the airline. Fly SAX requires R250 million as start-up capital for the airline, of which R200 million will be sourced from the anchor investor and equity crowdfunding. The remaining R50 million will be sourced from the sale of the airline's assets, crowd funding as well as the anchor investor. Fly SAX only wants to purchase SA Express's flight routes, landing rights and aviation-related licences. Most of SA Express's value lies in its aviation licences.[21]

The airline's assets will be disposed of through a public auction and the profit will go towards the sale of SA Express. Any shortfall will be recovered from a bank guarantee to be provided to the joint liquidators for R50 million.[22]

In a letter to Parliament dated 23 November 2020, the Minister of Public Enterprises, Mr. Pravin Gordhan, stated that the airline would not prepare the 2019/20 Annual report and Annual Financial Statements as the contracts of employees who would have prepared the reports were suspended prior to the year-end audit.

Issues for Consideration

The Department should update the Committee on the provisional liquidation of the airline. What is happening with SAX employees' salaries?

The Department should comment on whether the sale of SA Express to private parties. What is happening with Government's vision for a consolidated aviation industry in South Africa, with the merger of SAA and SAX? What is happening with the low-cost carrier Mango?

6. TRANSNET

In January 2020, the Minister of Public Enterprises approved the appointment of Portia Derby as the permanent CEO of Transnet, a post that has been vacant for more than six months. Ms. Derby is a former Director-General of the DPE, so she is familiar with the entity.[23]

Ms. Derby has been filling vacant posts in her first few months at the entity. She has also signed off on a new top leadership structure dated 28 February 2020.[24]

[20] Maeko (2020)
[21] Mahlaka (2020b)
[22] Maeko (2020)
[23] Smith (2020)
[24] Mashego and Stone (2020)

Transnet recorded a profit for the 2019/20 financial year of R3.9 billion, a decrease of 34.9 per cent on the R6 billion achieved in the prior year, primarily due to the fair value adjustments of R762 million being significantly lower than that of the prior year. The entity also received a qualified audit opinion based on its irregular expenditure.[25] At its interim results the entity recorded a loss of R3 billion for the period ending 30 September 2020, due to a 17.3 per cent decrease in revenue mainly due to the impact of the Covid-19 lockdown restrictions on rail, port and pipeline volumes. Operating expenses also increased by 4.4 per cent due to the high proportion of fixed costs.[26]

Issues for Consideration

The Department should update the Committee on how the national lockdown has impacted on Transnet's operations as well as on its financial operations.

On 02 April 2020, Transnet recorded its first positive COVID-19 case.[27] How is Transnet ensuring the safety of its employees amid the on-going global pandemic?

The entity received a qualified audit due to its irregular expenditure. How is the Department ensuring that the entity does not receive another qualified audit opinion for the 2020/21 financial year?

The Department should update the Committee on the progress made in corporatizing Transnet National Ports Authority (TNPA) as advocated by the Competition Commisssion. How will the corporatisation of the entity affect Transnet's overall financial position?

7. DENEL

A new Board was appointed at Denel in April 2018. The Board was tasked with investigating the allegations of fraud and corruption at the entity as well as bringing the entity back to financial and operational sustainability. The Turnaround Strategy addressing the governance and operational issues was approved by the Board and shareholder and is currently being implemented. The Turnaround Strategy involves disposing of non-core assets and entering into strategic partnerships. The Board is optimistic that they are making progress in addressing the audit findings and implementing the Turnaround Strategy.

In June 2020, Denel updated the Committee on its Turnaround Strategy. Some of the key achievements included the following:

- Cumulative cost savings in excess of R1 billion since April 2018, driven mainly by 27 per cent reduction in employee numbers.

[25] Transnet (2020a)
[26] Transnet (2020b)
[27] Rall (2020)

- Exit of Aerostructures with an annualised benefit of R260 million from 30 June 2020 going forward.
- Exit of loss-making and onerous contracts, i.e. Venezuela, DRC and Chad.
- Closure of the loss-making LMT subsidiary which is in business rescue and in its final stages of closure.
- Overdue creditors have been reduced by more than 80% and payment plans for the remainder are in place.
- Good progress made with the establishment of the production baseline on the Hoefyster Section Variant, which will open the way for the re-set of the production baseline and enable delivery of the vehicles to the South African National Defence Force (SANDF).[28]

In a letter to Parliament dated 30 November 2020, the Minister of Public Enterprises, Mr. Pravin Gordhan, informed the Speaker that Denel has not been able to finalise and submit their annual report for the 2019/20 financial year within the prescribed timeline due to challenges with finalising their respective external audits.

Issues for Consideration

The Department should update the Committee on the implementation of the Turnaround Strategy. Has progress been made in implementing the strategy? Is the company financially stable going forward?

The Department should update the Committee on the status of the employees at Denel. Are the employees being paid?

How has the national lockdown due to the COVID-19 pandemic affected the company?

8. ALEXKOR

Over the past several years, Alexkor has been characterised by steadily falling production and years of successive losses. Due to the entity's financial challenges, the entity was unable to submit its 2018/19 annual report and audited financial statements timeously. The entity submitted its annual report in November 2019, two months after the stipulated due date. The entity was able to submit its annual report once an Administrator was appointed during September 2019 to oversee the entity's operations. Alexkor received a disclaimer of opinion due to is going concern status as well as a lack of diversification which represents a sustainability risk as it only has one major revenue source in the form of its 51 per cent stake in the PSJV.

The Administrator was only appointed for a period of six months, September 2019 to March 2020. In a presentation dated 27 May 2020, the Department had proposed that the Alexkor

[28] Du Toit (2020)

Chief Executive Officer (CEO), Mr. Lemogang Pitsoe, be appointed as the accounting authority of Alexkor when the Administrator's contract expired, until such time that a decision was made on the appointment of a new Board or Administrator. The Department of Mineral Resources and Energy (DMRE) had been approached to consider secondment an official to take over the role of the Administrator whilst the exercise of restructuring the SOC is being undertaken and to look after the interest of state in the PSJV.[29]

Of the six options presented to the Committee on the future state of Alexkor, the preferred option was the consolidation of state mineral assets in order to optimise and align the state's participation in the mineral sector. A formal technical task team has been established to conduct further studies on the proposed option to transfer the mineral rights of Alexkor to African Exploration and Mining Finance Company (AEMFC). DPE and DMRE are the main members of the task team with other Departments invited to participate as and when required. The role of the task team amongst others include: comprehensive assessment of the condition and performance of Alexkor assets and development of a stakeholder consultation project to ensure support of the selected preferred option. Approval from cabinet on the implementation of the preferred option would be sought. It is envisaged that the process will be completed before the end of the current financial year, being 2020/21.[30]

In a letter to Parliament dated 30 November 2020, the Minister of Public Enterprises, Mr. Pravin Gordhan, informed the Speaker that Alexkor has not been able to finalise and submit their annual report for the 2019/20 financial year within the prescribed timeline due to challenges with finalising their respective external audits.

Issues for Consideration

The Department should update the Committee on the state of the entity. Has a board been appointed to oversee the entity and the PSJV? How far is the process to transfer the mineral rights of Alexkor to AEMFC?

The Department should update the Committee on the state of the community structures, including the Community Property Association and its composition. How has the Alexandra Bay and surrounding communities been affected by the financial difficulties facing the PSJV and Alexkor? What is the Department doing to assist the community at this time?

9. SAFCOL

In a letter to Parliament dated 24 November 2020, the Minister of Public Enterprises, Mr. Pravin Gordhan informed the Speaker that he would be unable to table the SAFCOL annual report and annual financial statements. The entity did not submit the 2019/20 annual report, audited

[29] Department of Public Enterprises (2020a)
[30] Department of Public Enterprises (2020b)

annual financial statements and audit report to the Minister or the National Treasury on 31 August 2020 as the audit was still being concluded by the Auditor-General of South Africa. After this, the audit must still be reviewed and finalised by the Audit committee and Board, before it can be submitted to the Department and then Parliament.

Issues for Consideration

The Department should update the Committee on the status of the 2019/20 audited financial statements of the entity.

The Department needs to update the Committee on the land claims as well as the progress on the turnaround plan.

10. CONCLUSION

The brief sought to provide the Committee with the most recent developments pertaining to the State owned companies (SOCs) overseen by the Department of Public Enterprises, as well as issues pertaining to the Department itself. Given the national lockdown due to the COVID-19 global pandemic which started on 27 March until 30 April 2020 at level 5, all of the entities businesses have been affected by the lockdown. The Department is to provide the Committee with an update on the entities on 03 February 2021. Some of the major issues raised is the future state of South African Airways and South African Express Airways, which are both under liquidation; as well as Eskom and Denel's progress on their turnaround strategies.

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ANNEXURE A – BRRR RECOMMENDATIONS (extracted from the BRRR 18 November 2020)

The Committee recommends that the Minister of Public Enterprises should:

10.1.1 Ensure that shareholder compacts are concluded by the third quarter of the year preceding the year covered by the compact.

10.1.2 Ensure that the Accounting Officer improves controls and systems to ensure the department achieves an unqualified audit outcome and matters of emphasis from each year must be addressed in the subsequent year.

10.1.3 Ensure that SOCs protect jobs in particular highly advanced technical skills to advance the manufacturing capability of the state. SOCs should invest in labour intensive infrastructure programmes to create employment.

10.1.4 Ensure that the follows through on cases opened with South African Police Services on corruption allegations at Alexkor and that the recommendations of Gobodo Forensic report are implemented.

10.1.5 Ensure that the R10.5 billion allocated to SAA is used for the intended purpose, particularly the payment of severance packages and legal obligations.

10.1.6 Ensure that the restructuring of Eskom is completed within the set timeframes and maintenance of power stations is done on time.

10.1.7 Outline the impact of the Section 34 Ministerial Determination on Eskom to the Committee on the current generation ability of Eskom.

10.1.8 Introduce specific targets for costs containment and revenue “output” generation in the Shareholder Compacts.

10.1.9 Review SOC Business Model to enhance sustainability of the companies, which is revenue enhancement and cost containment.

10.1.10 Ensure that SOCs invest in Research & Development to improve on innovation and creativity.

10.1.11 Align remuneration, performance and consequence management with remuneration guidelines.

10.1.12 Ensure the Department of Public Enterprises adhere to the Logical Planning Framework.

10.1.13 Enhance and streamline the DPE’s internal processes to ensure rapid response and timeous decision making in the department.

10.1.14 Focus on capacitating core technical functions, develop and enhance technical skills and ensure implementation of sound operational and systems engineering business processes to ensure effective technical oversight.

10.1.15 Ensure the implementation of a methodology and manner in which Boards are appointed to ensure independence and enable effective performance review with due consequence management.