NATIONAL TREASURY BRIEFING TO STANDING COMMITTEE ON APPROPRIATIONS

Presenter: National Treasury | 17 August 2021

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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BRIEFING ON CURRENT FINANCIAL POSITION OF KEY STATE OWNED COMPANIES (SOCS)

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DEVELOPMENT FINANCE INSTITUTIONS

LAND BANK

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Background

1. The Land Bank has **traditionally utilised the majority of its resources to support commercial agriculture at the expense of its developmental mandate**.

2. By the 2019/20 financial year, the percentage of the **Land Bank's asset base dedicated to transformation and development amounted to only 17 per cent**.

3. Below is a review of financial performance and position from FY2017 to Q3 2020, with FY2017 to FY2018 showing a deterioration in profitability and losses from FY2019 to Q3 2020. The Land Bank **excessive gearing** and **dwindling profitability** was a **credit rating downgrade** in January 2020. This precipitate liquidity constraints and a **default on debt** in April 2020.

4. The alarming gearing levels have been mitigated somewhat by the **R3 billion shareholder support** in September 2020.

Financial performance

Land Bank Key Financial Indicators (R'm)	FY2017	FY2018	FY2019	FY2020	FY2021*
Total Assets	45,442	49,218	51,120	46,159	47,206
Cash and cash equivalents	1,520	2,421	3,213	723	9,322
Loans and advances	40,976	43,150	43,225	41,560	34,567
Equity	6,455	6,229	5,327	2,523	5,056
Total Liabilities	38,987	42,989	45,793	43,636	42,150
Gearing ratio (Debt/equity)	586%	667%	831%	1636%	803%
Net profit/loss	367	254	(887)	(2,125)	(472)
NPL's	7.1%	6.7%	9.6%	18.1%	23.6%

* Q3 (31 December 2020) unaudited results

Gearing ratio calculated using funding liabilities/equity

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Financial performance (continued)

5. The continued liquidity constraints have negatively impacted on the Bank's support of the agricultural sector, with it being restricted to very limited disbursements to its existing clients, and no disbursements to new clients or loan facilities. Disbursements are still limited to 50% of cash collections.

6. The restricted disbursement of loan facilities, as well as client attrition has resulted in the reduction of the Bank's loan book, causing a negative impact on the Bank's prime source of revenue (interest income) and thus an increased threat to the Bank's financial sustainability.

7. The Land Bank posted a net loss of R472 million as at 31 December 2020 (FY2020: net loss of R2.1 billion). The YTD improvement in the net loss from the prior financial year is primarily the result of lower impairment provisions raised during the YTD. The gross impairment charge is driven by the increase in Non-Performing Loans (NPLs). The NPL ratio has increased from 18.1% in 2020 to 23.6% as at 31 December 2020, as a result of loan book deterioration and the declining book balance.

8. The R3 billion equity injection from the shareholder in September 2020 and cash collected from clients contributed to the increasing cash balances as at 31 December 2020. Since December 2020, despite the the Land Bank default status, it has repaid approximately 12% of the capital amount that was owing to its financial creditors, together with all associated interest.

9. The Land Bank has also stated in an announcement to lenders on 6 August 2021, that it wishes to pay back a further 10% of the capital amount outstanding (together with accrued, unpaid interest) to all financial creditors, including the all noteholders.

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Discussion

PROGRESS in CURING DEFAULT STATUS

10. Solutions put forth to cure the Land Bank's default status (liability solution V1.0) **required additional guarantees amounting to approximately R20 billion**. The guarantee could not be approved due to **not meeting the criteria for issuance of a guarantee;**

11. The current offer to the lenders is to switch their current debt instruments into a 5-year amortising note.

11.1 Government uses R7.0 billion fiscal allocation to buy a **portion** of the Land Bank's **developmental loan book** and **repay guaranteed debt** of R2 billion.

11.2 **Commercial** asset loan book is set aside for the lenders to manage down and recover what is owed to them (funders may not recover their full exposure).

Legal construct

12. Lenders are currently in an informal debt-standstill arrangement, i.e.. mutual agreement not to institute court action. Exception is Standard Chartered Bank.

13. No provision in Land Bank Act for business rescue, only liquidation through an Act of Parliament.

14. Legal opinions indicate current reference to judicial management in the Land Bank Act cannot automatically be substituted for business rescue, thus Act amendment is in progress (9-12 month lead time).

TRANSPORT AND AVIATION

SOUTH AFRICAN AIRWAYS (SAA)

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Background

1. On 6 December 2019, SAA's Board placed the airline into voluntary business rescue due as a result of liquidity constraints facing the airline and its inability to meet its financial obligations as and when they became due.

2. The SAA business rescue plan indicated a funding requirement of R13.2 billion which was revised by DPE to R19.3 billion to take into account the business rescue process, the restructuring of SAA's subsidiaries and funding for the launch of the new airline. Of the R19.3 billion, the DPE indicated that R5.3 billion would be provided by a Strategic Equity Partner and R14 billion from government.

3. **Government allocated R10.5 billion to SAA in October 2020 for the implementation of the business rescue plan.**

4. DPE had intended to utilise R2.7 billion from the R10.5 billion allocation to fund the airline's subsidiaries. However, this could not be done as the R10.5 billion was specifically and exclusively allocated for SAA and not its subsidiaries. Therefore, a Special Appropriation Bill was tabled by the Minister of Finance on 24 February 2021 to provide R2.7 billion to SAA subsidiaries.

5. The R2.7 billion is not in addition to the R10.5 billion already allocated to SAA in the Second Adjustments Appropriation Act. A total of R7.8 billion will be provided to SAA and the balance of R2.7 billion will be provided to SAA's subsidiaries once the Special Appropriation Bill is enacted.

6. Over and above the R10.5 billion allocated to SAA, DPE requested an additional R3.5 billion to complete the implementation of the business rescue plan. Cabinet did not approve DPE's request for additional funding when it was presented during the finalisation of the 2021 Budget.

7. At the time of the tabling of Special Appropriation Bill, the DPE had provided the following breakdown in respect of funding required for each subsidiary:

- South African Airways Technical SOC Ltd (SAAT) – R1 663 000
- Mango Airlines SOC Ltd (Mango) – R819 000; and
- Air Chefs SOC Ltd (Air Chefs) – R218 000.

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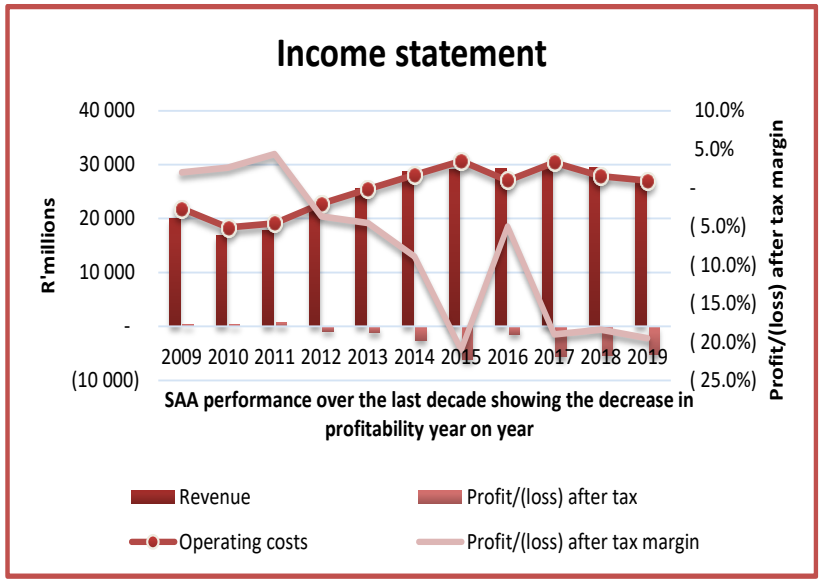
Financial performance



Source: South African Airways financial statement & NT analysis

8. SAA was unbundled out of the Transnet Group in 2007. The poor financial performance of the airline has resulted in SAA incurring over R34 billion in net losses over the 13 year period to the February of 2020, recording minor profits only in the 3 year period between 2009 and 2011.

9. The airline was grounded in March 2020 due to the COVID-19 pandemic and did not operate a flight schedule with only repatriation flights taking place at the onset of the pandemic. The entity continued incurring losses for the year ended 31 March 2021.

10. *SAA has incurred a net loss of R385 million for the quarter ended 30 June 2021 due to no flight schedules operated. The entity last produced audited financial statements in 2016/17 financial year however SAA expect to have the audits of 2017/18 to 2020/21 financial years begin in the second half of 2021.*

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Mango

11. Mango has incurred a R291 million net loss for the period ending 30 June 2021. The entity is currently experiencing liquidity challenges as it is unable to meet its monthly obligations and pay its debts as and when they become due.

12. Mango has accumulated debt which currently amounts to R2.7 billion. The R819 million allocated to Mango in the 2021 Special Appropriation Act will be insufficient to provide funding for the settlement of debt or the provision of working capital.

13. On 10 August 2021, the South Gauteng High Court granted the Board of Directors' application to place Mango under voluntary business rescue.

SAA Technical

14. SAAT incurred a net loss of R244 million during the quarter ended 30 June 2021. The entity currently owes SAA R925 million and is owed R790 million by Mango.

15. SAAT had a bank balance of R27 million as at the 30 June 2021. The current financial challenges faced by Mango and the decision to place the airline in business rescue will make it difficult for SAAT to recover the R790 million owed to it by Mango.

Air Chefs

16. Air Chefs incurred a net loss of R9.5 million for the quarter ended 30 June 2021 and is technically insolvent with negative net asset value of R6.4 million. Bridging finance of R41 million was provided to Air Chefs by SAA which was utilised to pay creditors and employee costs.

17. As at 30 June 2021, Air Chefs had a cash balance of R17.6 million. The allocated R218 million to Air Chefs is expected to be utilised to settle outstanding creditors of R76.4 million and implement a restructuring process in terms of Section 189 of the Labour Relations Act.

SOUTH AFRICAN EXPRESS AIRWAYS (SA EXPRESS)

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Background

1. SA Express was placed under **involuntary business rescue** by the South Gauteng High Court on 6 February 2020 following a court application by one of the airline's service providers.

2. The Business Rescue Practitioner (BRP) requested government support in the form of a guarantee to enable the airline to secure Post Commencement Funding (PCF) from commercial banks. The Department of Public Enterprises (DPE) did not formally submit a guarantee application to National Treasury (NT).

3. The BRPs launched an urgent court application on 25 March 2020 to provisionally place the airline under liquidation as a result of the delay in securing funding. DPE did not oppose the provisional liquidation application. The South Gauteng High Court granted the provisional liquidation order on 28 April 2020. This provides an opportunity for all affected parties including creditors, employees and trade unions to make submissions and put forward reasons before 9 June 2020 on why the court should not order the final liquidation of the airline.

4. Government had a R164 million contingent liability exposure in relation to SA Express made up of R123 million for RMB aircraft leases plus R41 million for Letters of Credit for RMB and Nedbank.

5. Government has allocated R164 million to SA Express in 2020/21 to cover these contingent liabilities. Its likely that there will be a call on these liabilities by SA Express' lenders as the airline has now been placed into provisional liquidation.

6. A payment of R143 million was made by government to the airline's creditors on 17 July 2020. An additional demand amounting of R11 million is expected from Rand Marchant Bank for the outstanding letters of credit issued by the bank to various beneficiaries on behalf of SA Express.

AIR TRAFFIC AND NAVIGATION SERVICES (ATNS)

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Background

1. ATNS provides services to nine South African statutory airports which are operated by Airports Company of South Africa (ACSA) and 11 regional airports, as well as St Helena on a contractual basis

2. Reduced aircraft movements as a result of the COVID-19 pandemic. Given that ATNS' revenue is linked to aircraft movements, the entity has experienced significantly low tariff revenue in 2020/21.

3. The ATNS Act requires ATNS to seek permission from the Regulating Committee in order to levy air traffic services charges, provide air navigation infrastructure and conduct air traffic and air navigation services.

4. However, the current permission is expected to remain in effect for a full five-year period which will see ATNS charging tariffs that were set five years ago. Given the time lapse and the impact of COVID-19, ATNS believes that this will pose a threat to the entity's going concern

Financial performance

5. The total revenue decreased by 67% from R1.67 billion in 2019/20 to R547 million in 2020/21. This necessitated the company to review its budget and implement cost containment measures which resulted in the reduction of operational cost by 30% to R1.1 billion which is higher than the revenue generated.

6. ATNS utilised its cash reserves to cover the revenue shortfall. As at March 2020, ATNS had R1.6 billion in cash reserves, however, due to the declining traffic revenues, the reserves have decreased to R833 million by 31 March 2021.

7. ATNS' projections had initially indicated that the cash reserves were expected to be depleted by November 2021. However, cash reserves are now expected to be depleted by March 2022 given the revised cost containment measures.

8. ATNS is seeking to secure a borrowing facility which will be used to fund its capital expenditure programme and operations during the post Covid-19 recovery period.

AIRPORT COMPANY SOUTH AFRICA (ACSA)

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Background

1. ACSA owns and manages nine South African Airports, including the OR Tambo, Cape Town and King Shaka international airports.

2. The South African government owns 74.6% of ACSA while the Public Investment Corporation (PIC) own 20%. The remaining 5.4% shareholding is held by other minority shareholders of which 1.2% is held in a Staff Share Incentive Scheme.

3. Prior to the outbreak of the COVID-19 pandemic, ACSA was performing well with significant cash balances and net debt of R4.6 billion against an asset base of R31 billion.

4. Due to the decreased passenger volumes and decreasing revenues, an amount of R2.3 billion was provided to ACSA in the Adjustments Appropriation Act which was aimed at assisting the company with the much needed working capital given its ongoing liquidity constraints as a result of the COVID-19 pandemic.

5. ACSA implemented various cost reduction and asset disposal initiatives aimed at preserving cash given the adverse operating environment. This included limiting capital expenditure, the introduction of a voluntary severance packages programme in an effort to reduce staff costs and selling ACSA's 10% stake in Mumbai Airport International Limited to ensure sufficient cash remains to navigate through the pandemic.

6. The latest cash forecast indicated that ACSA will have sufficient cash receipts during the forecast period, July 2021 to June 2022. However, this may change should there be additional travel restrictions resulting in reduced travel demand.

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Financial performance

7. ACSA's performance has since deteriorated due to the travel restrictions imposed as a result of the COVID-19 pandemic. At the onset of the lockdown, South Africa saw a complete closure of passenger travel, resulting in the immediate decline in travel demand.

8. The total passenger traffic has declined by 78% from 41 million in 2019/20 to 9 million in 2020/21. The reduced passenger numbers resulted in a 75% decrease in revenue to R1.8 million in 2020/21 (2019/20: R7.1 billion) which has led to liquidity constraints.

9. Although the decrease in revenue has severely impacted the liquidity position of ACSA, the entity is solvent with a net asset value of R20.5 billion as at 31 March 2021.

10. As a result of the national lockdown effects on ACSA's available cash on hand, the board approved to revise the initial capex budget of R2.8 billion. In 2020/21, ACSA spent R756 million compared to the revised budgeted amount of R810 million. All new capital investment decisions and contract awards have been placed on hold pending the review of their business case and alignment with the business prioritisation criteria.

11. Given the current constraints on the fiscus, it may be prudent if all the shareholders commit funds to assist ACSA whilst the aviation sector recovers from the impact of COVID-19 and the subsequent travel restrictions.

GENERAL SECTOR

DENEL

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Background

1. Denel has been experiencing liquidity and solvency challenges that emanated from, amongst others, weak governance structures, poor working capital management, a high-cost base, declining revenues and poor contracting which resulted in the entity taking on unprofitable projects.

2. In response, the entity is currently in the process of implementing a turnaround plan. However, this has been delayed by the consultation process between relevant Departments to find alignment on potential disposals and the future state of the Defence industry overall.

3. Government has supported Denel through guarantees of R5.9 billion and recapitalisations amounting to R2.3 billion. Government also approved to step-in on Denel's guaranteed debt and settle the R3.2 billion currently held under the Domestic Medium-Term Note (DMTN) Programme.

Financial performance

4. Denel reported its year-to-date sales at R2.8 billion, compared to the budgeted sales of R3.6 billion, indicating that sales are 22% behind budget. Denel's 2020/21 revenue performance is indicative of the challenges faced due to cash flow constraints (resulting in the loss of key skills due to the non-payment of salaries and the non-supply of inventory due to non-payment), Denel's damaged reputation in the market and the Covid-19 lockdown.

5. As at 31 March 2021, Denel reported a net loss. Denel states that this is due to the above-mentioned reduced sales and under recoveries as a result of low activity in the entity, largely driven by Covid-19 pandemic, cash constraints and the loss of key personnel. In addition, Denel's gross profit margin was reported at 18% against a budgeted 22%. Whilst there was a slight reduction in salary costs, the operating cost margins have increased to 72% against a budgeted 24% as a result of reduced revenues and higher under-recoveries.

6. As at 31 March 2021, the cash available amounted to R606 million, with R333 million of this being ring-fenced in Escrow accounts and project finance structures. The entity also reported its equity at an insolvent position of R3.8 billion for the 2020/21 period. The going concern risk is high due to poor financial performances affecting this position over a few years, which is also posing challenges in attracting adequate bank facilities to finance operations.

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Financial performance (continued)

7. Since March 2020, the entity has not paid full salaries to employees and owes statutory payments obligations such as SARS, employee pension contributions and medical aid.

8. Denel has government guaranteed debt amounting to R3.2 billion of which R2.8 billion matures in August and September. The entity is not in a position to redeem due to its financial challenges.

Governance

9. The entity is faced with governance challenges in terms of executive management and board of directors. During the period under review, the CEO and CFO resigned. A board member was appointed as an acting CEO, however he also resigned from both positions.

10. The chairperson and eleven other members of the board also resigned. Currently the entity has only four board members from the initial sixteen members.

11. The Auditor General also finalised the audit as at 31 March 2020 and issued a disclaimer audit opinion, citing matters of going concern, material errors in the consolidated financial statements and inadequate internal controls, amongst others.

SOUTH AFRICAN SPECIAL RISK INSURANCE ASSOCIATION (SASRIA)

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Background

1. Sasria has historically been a self-sustaining entity with a healthy balance sheet and no need for Government support. However, in July 2021, an increase in civil unrest and looting was experienced in KwaZulu Natal and Gauteng. For Sasria to maintain a 100% solvency cover ratio (SCR), it requires Government support through an equity injection.

2. National Treasury media statement on 28 July 2021 outlined that R3.9 billion will be allocated to Sasria.

Financial performance

3. For the period ended 31 March 2021, Sasria reported that the entity received 2 956 claims, which is a decrease of 31% compared to the total claims of 4 275 reported during last year. This is also reported to be the lowest number of claims received in the past four years, largely attributed to restrictions linked to the Covid-19 lockdown.

4. Sasria forecasts a total net profit before tax of R2 billion for the year ended 31 March 2021, against a budgeted R109 million (indicating a positive variance of 1712.4%). Administration and marketing expenses are forecast at R569.8 million, against a budgeted R481.1 million. This is an over-expenditure of 18.4%, and also reflects an increase of 15.4% compared to the same period last year. Sasria's financial assets account for R9.6 billion (comprising of R3.3 billion in cash and R6.3 billion in investments). In addition, the entity's equity (retained earnings) is reported at R8.5 billion (31 March 2020: R7 billion)

ENERGY

ESKOM

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Background

1. Eskom's access to funding in both the domestic and foreign markets has been restricted due to decreased investor confidence driven by poor financial performance, saturated borrowing capacity, credit rating downgrades and uncertainty around Eskom's unbundling.
2. Eskom remains reliant on Government support to maintain a positive cash balance and remain a going concern. Continued operational losses will put more pressure on Eskom's financial stability.
3. Government provided R56 billion in 2020/21 and has disbursed all of the allocated R31.7 billion for 2021/22 .
4. National Treasury and DPE officials to continue working closely with Eskom to manage its daily cash flow requirements to ensure that the entity's) financial position does not negatively impact Government cash management, ii) implements an orderly separation of the business into three entities and iii) undertakes a path of just transition.
5. Eskom successfully achieved the target for the Commercial Operation (CO) of two units in the 2020/21 financial year. Kusile Unit 2 and Unit 3 achieved CO on 29 October 2020 and 29 March 2021, respectively, contributing 1 598MW to the national grid.

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Financial performance

1. For the 4th Quarter of the 2020/21 financial year (FY), the Eskom Group reported revenues of R204.3 billion, this represents a R4.9 billion increase year-on-year (YoY). Eskom continues to experience revenue pressure as a result of declining and stagnating electricity sales volumes, with customers switching to alternative sources of energy, as well as the loss of sales volumes from rotational load shedding and load curtailment.

2. From 1 April 2021, tariffs for customers directly supplied by Eskom increased by 15.06%. In compliance with the Municipal Finance Management Act, 2003 (MFMA), from 1 July 2021, Eskom's tariffs for municipal distributors will increase by 17.80%. This tariff adjustment will contribute towards improving Eskom's sustainability.

3. Eskom was forced to implement load shedding for a total of 47 days during 2020/21 (March 2020: 46 days). Ten days of continuous load shedding was implemented from 10 to 19 March 2021, the longest continuous load shedding ever implemented.

4. Eskom has returned its focus to completing planned maintenance, in a bid to improve energy availability. Eskom catered for a total of 73 outages in the base plan for 2020/21. As at 31 March 2021, 60 of those outages were executed and 13 deferred. Furthermore, an additional 24 short-term outages were completed. In addition, Eskom have launched a Reliability Maintenance Recovery (RMR) Programme in August 2020, with the purpose of ensuring proper outage scope assurance and outage planning.

5. Eskom has a considerably high level of debt, beyond what it can afford to hold without Government support. Total debt stood at R400.5 billion as at 31 March 2021, a marked improvement compared R483.6 billion as at 31 March 2020. Eskom's Government Guarantee facility of R350 billion is still available for the completion of its capital expenditure programme, of which R303 billion has been committed, leaving R47 billion available for future funding as at 31 July 2021

TELECOMMUNICATIONS

SOUTH AFRICAN POST OFFICE (SAPO)

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Background

1. The Postal Services Act (1998) grants it an exclusive mandate to conduct postal services within the reserved sector (mail under 1kg). The Act furthermore makes provision for the regulation of postal services and operational functions of the postal company, including universal service obligations and the financial services activities of Postbank. SAPO's USO grants were reinstated in the 2019 financial year and is budgeted to receive R1.5 billion for its USO obligations over the MTEF period.

2. SAPO has also been appointed as the main implementing agent for the distribution of social grants.

3. SAPO's failure to successfully implement its previous turnaround plans which included revenue diversification initiatives coupled with addressing its high fixed cost base, mainly comprising staff costs, has negatively impacted its profitability. This has impacted SAPO's ability to generate sufficient cash from operations, resulting in liquidity constraints and an inability to service obligations as they fall due. This, along with years of unfunded losses due to SAPO's failure to implement previous turnaround plans and adapt their business to the changing industry landscape has resulted in SAPO's financial position deteriorating rapidly. This has hampered service delivery standards, which in turn negatively affect revenue generation.

Financial performance

SAPO Key Financial R'000					
R'mil	Historical 2016/17	Historical 2017/18	Historical 2018/19	Historical 2019/20	Current 2020/21*
Total Revenue	4,564	4,449	5,315	4,102	3,355
Total Costs	5,582	5,167	6,787	6,476	6,360
Net Profit/(loss)	(987)	(908)	(1,099)	(1,768)	(2,431)
Cost to income	122%	116%	128%	158%	190%
Total assets	13,235	13,468	16,070	11,067	7,828
Total equity	901	3,523	5,186	3,671	(2,576)
Total debt	12,333	9,945	10,884	7,395	10,404
Gearing ratio	1368%	282%	210%	201%	-404%
Current ratio (times)	1.4	1.2	1.4	0.7	0.4

*SAPO Q4 Performance Report, unaudited financial information

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Financial performance (continued)

4. Revenue for 2020/21 declined by 18% to R3.4 billion (2019/20: R4.1 billion). The decline in revenue year-on-year is due to the Covid-19 lockdown and associated business slowdown; digital substitution; lack of technology investment; outdated tools of trade; a product offering which does not align to the current consumer needs and delayed implementation of strategic partnerships to increase revenue.

5. Expenses of decreased 6% to R6.4 billion in 2020/21 (2019/20: R6.5 billion). Expenses continue to exceed revenue generated; resulting in severe pressure on the cash flow position. Staff cost accounts for 60%of total expenses and is higher than the revenue generated for the year. Despite SAPO's dire financial position, they still approved a 6.5% salary increase during the financial year.

6. The high fixed cost base and declining revenue resulted in SAPO forecasting a preliminary year to date net loss of R2.4 billion (YTD March 2020: net loss of R1.8 billion), which remains unfunded. SAPO has also still been posting increasing net losses despite allocations to cover its USO.

7. SAPO's liquidity position has been deteriorating historically due to declining revenues and the separation of the Post Bank during the 2020 financial year. The impact of the lockdowns as a result of the Covid-19 pandemic has added further pressure to SAPO's liquidity position and at the end of the 2020 financial year, SAPO has outstanding statutory payments to creditors of R2.9 billion.

8. The continued unfunded net losses has also resulted in SAPO reporting negative equity during the 2021 financial year, rendering SAPO technically insolvent.

BRIEFING ON MODEL USED BY ASSET AND LIABILITY MANAGEMENT DIVISION TO MAKE KEY GOVERNMENT GUARANTEE DECISIONS WHEN REQUIRED BY STATE OWNED COMPANIES

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LEGISLATIVE FRAMEWORK

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CONSTITUTION

1) Section 218(1) of the Constitution stipulates that "The national government, a provincial government or a municipality may guarantee a loan only if the guarantee complies with any conditions set out in national legislation".

2) Section 218(3) stipulates that "Each year, every government department must publish a report on the guarantees it has granted".

PUBLIC FINANCE MANAGEMENT ACT, ACT NO 1 OF 1999

1) The Public Finance Management Act 1999, Act No 1 of 1999 (PFMA) gives effect to Section 218(1) of the Constitution.

2) Section 66 of the PFMA prescribes the powers of Government and the Public Entities to borrow money, issue guarantees, indemnities and or securities that may bind the National Revenue Fund.

3) Section 70 of the PFMA stipulates the responsibility of Cabinet members for the issuance of guarantees, indemnities and or securities as well as duties of the responsible Cabinet Member. It also stipulates that the Minister of Finance has to concur with the issuance of such guarantees, indemnities and or securities.

4) Section 70(3) of the PFMA stipulates that "A Cabinet member who seeks the Minister's concurrence for the issue of a guarantee, indemnity or security, must provide the Minister with all relevant information as the Minister may require regarding the issue of such a guarantee, indemnity or security and the relevant financial commitment

POLICY FRAMEWORK

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1) Government Guarantee is a contractual obligation to cover the beneficiaries in meeting their financial obligations such as on loans/bonds repayments and/or interest payments under specific circumstances.

2) Guarantees were intended to be issued based on the following 1996 Cabinet approved guidelines:
   a) Limiting the issuance of guarantees to reduce the gross contingent liability obligation;

   b) Allow public entities to borrow on the strength of their balance sheets using guarantees;

   c) Using guarantees, in exceptional cases to support restructuring objectives and to meet international agreement obligations; and

   d) Levying guarantee fees to equalise benefits on borrowing cost margins of public entities borrowing with a guarantee and those borrowing without a guarantee.

FISCAL LIABILITIES COMMITTEE

National Treasury established the Fiscal labilities Committee (FLC) to advice Minister on management of CLs.

The Terms of Reference include:

1) Risk assessments of counterparty credit quality and advice Minister accordingly on applications;
2) Monitor concentration in portfolio;
3) Adopt a limit for total liabilities, set conditions and monitor adherence;
4) Monitor utilisation of guarantees;
5) To provide oversight on the implementation of the contingent liability policy of the National Treasury;
6) Satisfy itself of adequate systems in place; and
7) Consider the introduction of a funded contingency reserve account.

GUARANTEE APLICATION PROCESS

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STEP 1:

Applicant submits request for a guarantee to its Executive Authority/the responsible Minister. Upon approval, the responsible Minister forwards request to the Minister of Finance. Request must cover the following issues:

1) A description of the project and profile of applicant; Proposal; Rationale; Financial analysis; Impact of activity to be supported by guarantee or transaction on the applicant; Industry/Sector analysis; Broader government imperatives such as economic development, employment and economic growth; Legal implications, if any; and the duration of the financing, guarantee or transaction must be specified.

STEP 2:

1) Relevant divisions within the National Treasury will assess the application by reviewing:
2) Compliance with Section 66 (3)(b)and (c) and Section 70 (1)(a) and (b) of the PFMA;
3) The mandate and financial position of applicant;
4) The capital investment programme and funding requirement against which the guarantee will be used;
5) Impact of additional borrowings on the financial sustainability of the applicant; and
6) The guarantee framework that guides the use of the guarantee and reporting to fiscus.

GUARANTEE APLICATION PROCESS CONT…

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STEP 3:

Once analysis is conducted and the application meets the minimum criteria, it will be submitted to FLC secretariat to be included in the agenda of next meeting.

During the meeting the FLC will:

1) Evaluate and deliberate all requests;
2) Consider a report on the status of the portfolio detailing the level and quality of the exposure;
3) Consider a report on adherence to guarantee or borrowing limit conditions; and
4) Take decision on whether to support or reject the application.

After the recommendation is made by the FLC, a memorandum is prepared and sent to the Minister with FLC recommendation whether to reject or concur with approval of guarantee.

STEP 4:

If approved, legal documentation (framework agreement) is prepared and forwarded to the Executive Authority for approval and signature. After which they are forwarded to the Minister for his decision with regard to concurrence to the approval of the guarantee or transaction.

GUARANTEE APLICATION PROCESS CONT…

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STEP 5:

After the decision to concur with the approval has been made by the Minister, a letter should be sent to the applicant, indicating the conditions attached to the guarantee or transaction, the applicable once-off administrative fee as well as the annual transaction fees.

STEP 6:

The guarantee or transaction is recorded in the contingent liability register detailing the following information:

1) The guarantee/transaction amount;
2) The issue and maturity dates;
3) Currency denomination;
4) Conditions attached to the transaction;
5) Relevant fees payable; and
6) Administrative fees.

MINIMUM CRITERIA FOR THE SUBMISSION OF GUARANTEE REQUESTS

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1) In order to improve the quality of requests submitted to FLC and Minister of Finance, an Instruction Note outlining minimum criteria to be met before guarantees are considered was issued by the Minister of Finance in December 2020.

2) Minimum criteria includes:

a) There should be a demonstrable need for government to accept the risk (i.e. the underlying transaction must be necessary in the fulfilment of the applicant's mandate in accordance with government's overall strategy);

b) The applicant must demonstrate adequately that it will generate sufficient cash flows during the term of the underlying transaction (e.g. debt obligation) that will enable it to settle its obligation in line with the terms of the transaction timeously;

c) The guarantee, security, indemnity, borrowing limit, or transaction for which an approval is being applied for, should be offered by government and should be in line with all applicable legislation;

d) The type of project that the underlying financing is needed for should be in line with the applicant's mandate;

MINIMUM CRITERIA FOR THE SUBMISSION OF GUARANTEE REQUESTS CONT…

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1) Sufficient evidence that, a clear assessment of the underlying project viability or lending activity in the case of a development finance institution (DFI), has been conducted by the relevant Ministry should be submitted as part of the application. Where it is determined that the underlying project will yield social benefits without generating enough revenue and returns that will enable the public entities to service the required debt, then the project or lending activity should be funded through the budget appropriation process; and

2) Public entities that have previously not adhered to guarantee conditions should not submit applications for new guarantees.

Requests that do not meet the criteria will not be considered by the FLC and consequently by the Minister of Finance for approval or concurrence.

ESKOM'S COMPLIANCE WITH CONDITIONS IMPOSED IN TERMS OF SECTION 1(2)(B) OF THE SPECIAL APPROPRIATION ACT, 2019 (ACT NO. 25 OF 2019)

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PROVISIONS OF SPECIAL APPROPRIATION ACT, 2019

1) The Special Appropriation Act, 2019 (Act No. 25 of 2019 - “Act”) was enacted in November 2019 and provide for:
   a) additional financial support to Eskom of R26 billion and R33 billion, bringing the total allocations to R49 billion and R56 billion for 2019/20 and 2020/21 respectively.
   b) that the money be transferred to Eskom in each financial year to assist Eskom with its financial obligations.
   c) that the amount be transferred in portions and on dates that the Minister of Finance determines, taking into account Eskom’s financial position as verified by the National Treasury.

PROVISIONS OF SPECIAL APPROPRIATION ACT, 2019 CONT..

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1) The Act further provides that:

   I. to promote transparency and effective management of amount, the Minister of Finance, in writing-

      a) may impose conditions to be met by Eskom before any part of amount is transferred.

      b) must impose conditions to be met by Eskom after transfer of any part of amount.

      c) must stop use of any part of amount in respect of which conditions imposed, have not been met and report stoppage to Parliamentary committees.

   II. any part of amount not transferred to Eskom by end of relevant financial year reverts to National Revenue Fund.

CONDITIONS IMPOSED IN 2020/21

1) On 20 August 2020, the Minister of Finance approved the conditions attached to be imposed on the allocation for 2020/21 after consultations with Department of Public Enterprises (DPE) (***see Annexure A***).
2) These conditions were also submitted to the Chairpersons of the Standing Committee on Appropriations (SCOA) and the Select Committee on Appropriations (SeCOA) of Parliament as these committees will also be monitoring Eskom's compliance.
3) The approved conditions are aimed at enforcing transparency and effective management of Eskom.
4) In order to satisfy government that progress is being made towards achieving these conditions, a Eskom Weekly Monitoring Task Team was established between National Treasury, the Department of Public Enterprises and Eskom.
5) In reviewing compliance with these conditions, National Treasury identified areas where Eskom and DPE fully complied, not complied and partially complied with the required information:
   a) Fully complied means that all the required information was provided.
   b) Not complied means the information was not provided or dates were not met.
   c) Partially complied means that the information provided did not meet National Treasury's requirements and therefore Eskom has to submit additional supporting information in order to fully comply with the conditions.

ESKOM'S PERFORMANCE AGAINST CONDITIONS

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1) 21 conditions were imposed on Eskom and were clustered into three categories as follows;
   a) **Financial conditions**: 16 out of the 17 complied with, and *1 non-compliance*.
   b) **Operational conditions**: All 3 conditions were complied with.
   c) **Restructuring conditions**: The 1 condition was complied with.
2) As at 31 March 2021, the entire R56 billion equity allocation for 2020/21 was disbursed as Eskom complied with the majority of its conditions, with the exception of one condition.
3) Eskom did not comply with condition 14, discussed below:
   a) **Condition 14: Eskom must provide to National Treasury and the Department of Public Enterprises monthly updates on the implementation of the milestones as per the project plan submitted in relation to disposing of Eskom Finance Company (EFC) by 31 March 2021.**

ESKOM'S PERFORMANCE AGAINST CONDITIONS CONT…

1) Disposal of EFC was required by 31 March 2021, however Eskom experienced significant delays in the transaction due to the COVID-19 pandemic restrictions, which delayed potential bidders internal processes.
2) Eskom received and evaluated one bid which met the minimum threshold. However, it should be noted that the offer received equated to approximately 50% of the book value of EFC. Additionally, the bidder indicated that the funds would not flow immediately to Eskom, but rather in tranches as they work to refinance the loan book.
3) The Eskom Board accepted the offer from the preferred bidder on 28 January 2021. Eskom reported that the negotiations and conclusion of the agreements were progressing, with both parties agreeing to the effective date of the transaction to be 31 March 2021, subject to all approvals being obtained.
4) Eskom indicated that they were ready to conclude the transaction and comply with the equity condition, once final Public Finance Management Act approval received from the DPE.

ESKOM'S PERFORMANCE AGAINST CONDITIONS CONT…..

1) However, in a letter to dated 30 June 2021 addressed to the Minister of Finance, the Minister of Public Enterprises stated that although Eskom did everything with their control to comply with this condition of the Act, DPE does not support the execution of this transaction in its current form and has decided to defer the disposal of the EFC until such time that the market conditions have improved, so that it can attract increased investors' appetite and positively contribute to Eskom's liquidity challenges.
2) Furthermore, the Minister of Public Enterprises emphasised that DPE is still committed to executing the disposal of the EFC, but believe that such a disposal must positively contribute to Eskom's liquidity challenges which is not the case with the current offer.
3) DPE's view is that the proposed offer, which is R2 billion below the EFC valuation, will amount to value destruction and the terms of the payment of the proceeds from this transaction are not what was envisaged.
4) Despite Eskom not fully complying with all the conditions imposed, National Treasury concluded that the submitted information and the weekly progress updates that Eskom provided during the weekly monitoring meetings were sufficient to allow the disbursement of the R56 billion for 2020/21.

CONDITIONS FOR 2021/22

1) In continuing to support Eskom to remain financially sustainable, Government appropriated R31.7 billion in the Appropriation Act (10 of 2021) for 2021/22, while R21.9 billion and R21 billion have been provisionally allocated in 2022/23 and 2023/24 respectively.
2) Section 4(1)(a) of the Act enables Minister of Finance to impose conditions on an amount in the Schedule to the Appropriations Act in order to promote transparency and accountability and effective management of the appropriation.
3) In terms of conditions that are imposed through the normal Appropriations, the Minister of Finance has delegated this function to the Deputy Director-General: Public Finance. Following the President's assenting to the Appropriation Bill on 28 June 2021, the conditions were formally communicated to Eskom (***see Annexure B***).
4) As at 19 July 2021, the entire R31.7 billion for 2021/22 was disbursed to Eskom, with the last tranche of R11.7 billion being disbursed on 01 July 2021. Although the funds have been fully disbursed to Eskom for the debt and interest payments that needed to be urgently settled, Eskom is still providing the required information in the format that will enable National Treasury to continue undertaking its oversight responsibilities towards the entity.

THANK YOU!

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