PRESENTATION TO STANDING COMMITTEE ON APPROPRIATIONS

Update on State Owned Companies

PRESENTED BY:

Asset and Liability Management Division

Date: 30 May 2023

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

STAY SAFE
VACCINATE TO SAVE SOUTH AFRICA

LAND BANK

national treasury

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LAND BANK: BACKGROUND

- The Land Bank has been in default since 01 April 2020 and since then, the Land Bank has been making capital reductions to reduce the debt and R18.1 billion has been repaid through capital repayments to date.
- Following the rejection of three versions of the liability solution by lenders, the Land Bank is still negotiating to conclude liability solution version in order to cure the default.

Equity Conditions imposed:

- Land Bank provide written assurance that it complies with Section 38(1)(j) of the PFMA, i.e., practices sound financial management.
- Land Bank provide evidence that it will safeguard R5 billion equity from legal action taken by its lenders.
- National Treasury and the Land Bank must agree on a sustainable business plan to operationalise the blended finance programme.
- Land Bank to provide written assurance that it will be able to safeguard the initial equity allocation plus all future returns from lenders.
- R3 billion of the R5 billion must be used for blended financing with the remaining R2 billion to be used to cure the default.
- The Land Bank must provide written confirmation to the Minister that the fiscal allocation will only be used for the purpose for which it was intended.

LAND BANK: RECAPITALISATION

- In 2021, R7 billion was approved for recapitalisation of the Land Bank. By March 2023, Land Bank had received a total of R6 billion.
- Due to the ongoing default position, the Land Bank established an escrow account wherein it transferred this money.
  - The fiscal allocation will remain in the escrow account until the Land Bank meets the equity conditions.
  - If the Land Bank does not meet the equity condition, the money will be returned to the National Revenue Fund.
- The remaining R1 billion of the R7 billion recapitalisation for FY2024 will be used to settle the remaining guaranteed lenders – the balance thereof will be transferred to the Land Bank for blended financing.
- Restructuring the Land Bank remains one of the key objectives towards enabling the Land Bank to fulfil its mandate as a Development Finance Institution (DFI).
- The Land Bank is currently working on a business case / strategy to create a sustainable entity that can fulfil its development and transformation mandate.

LAND BANK: Q4 2022/23 FINANCIAL SUMMARY

- As at end of Quarter 4 (31 March 2023), Land Bank recorded a net profit of R695.7 million against a budgeted loss of R184.0 million for the year and Prior Year (PY) profit of R1.4 billion. This is mainly due to a net impairment release of R450.2 million and a decrease in the non-interest expense driven by a decrease in the SLA admin fees as the Bank insourced that book.

- Land Bank generated net interest income of R702.6 million compared to R595.5 million reported in the PY primarily due to interest expense decreasing by R225 million attributable to lower funding liabilities.

- Funding Liabilities decreased to R22.5 billion (PY: R29.2 billion) due to capital and interest repayments during the year.

- Net loans and advances decreased to R15.3 billion (PY: R20.9 billion) due to the reducing loan book owing to restricted disbursements, and client settlements.

- The Rand value of non-performing loans (NPL's) has been reduced by R2.6 billion for the year through implementation of the NPL Remediation Strategies. The NPL ratio however increased from 47.7% at the end of March 2022 to 51.6% at the end of March 2023, due to the R7.0 billion reduction in the gross loan book.

ESKOM

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ESKOM: FINANCIAL CHALLENGES

- Eskom reported a loss before tax of R21.2 billion for the 2024 financial year, against a budgeted loss of R13.6 billion (March 2022: loss before tax R11.9 billion).
- Net revenue grew slightly to R259.2 billion (March 2022: R247.6 billion), largely driven by a regulatory standard tariff increase of 9.61% for the 2023 financial year. The non-payment of municipal and residential revenue continues to negatively affect Eskom's profitability.
- Eskom's sales volumes were impacted by generation supply constraints, leading to load curtailment and loadshedding, as well as prevailing economic conditions. Local sales volumes were 5.6TWh (3.1%) lower than budget and declined by 8TWh (4.3%) when compared to the previous financial year.
- Eskom's gross debt securities and borrowings increased to R439.1 billion as at 31 March 2023 (March 2022: R396.3 billion), which Eskom attributes largely to the impact of the weakening of the Rand on foreign denominated borrowings as well as debt raising activities.
- Eskom reported cash interest cover and debt service cover ratios of 1.28 and 0.58 respectively at year end, and remain well below acceptable norms, as cash generated from operating activities is insufficient to cover the cost of servicing debt (both interest and capital), prompting the need for Government support.
- During the 2022/23 financial year, Eskom received R21.9 billion in equity support through the Special Appropriation Act, 2019.
- Eskom's R350 billion Guarantee Framework Agreement (GFA) expired on 31 March 2023. In terms of utilization, Eskom has utilized R332 billion at financial year end. The expiry of the GFA does not impact the existing guarantees issued, which will remain in place until settlement of the related debt.
- Total invoiced municipal arrear debt increased to R58.5 billion at year end (March 2022: R44.8 billion). A total of 61 municipalities have total arrear debt of more than R100 million each. Eskom continues to pursue a multipronged strategy aimed at recovering the municipal arrear debt owed, with little success.

ESKOM: OPERATIONAL CHALLENGES

- Eskom Generation continues to experience unreliable performance of its power-generating plants mainly due to delayed and inadequate maintenance as well as delays in the commissioning of new plants, and faults detected in the new units that have been commissioned.
- Eskom's reported Energy Availability Factor (EAF) at 56.03%, as at 31 March 2023 which is significantly lower than the previous year (March 2022: 62.02%), and significantly worse than the target of 65%. The decrease in EAF compared to the previous year is largely due to a significant increase in unplanned losses (UCLF) to 31.92% (March 2022: 25.35%).
- Additionally, average partial load losses of 6 057MW have increased substantially compared to the previous year (March 2022: 4 851MW) and performed significantly worse than target. The increase in partial and full load losses contribute significantly to the high UCLF.
- Due to the poor performance of the generation fleet, Eskom has had to significantly increase the usage of its own and IPP OCGT's to support the power system and limit the stage of loadshedding. Loadshedding was implemented on a total of 280 days during the year.
- OCGT production for the financial year was reported at an unprecedented high of 3 018GWh, as at 31 March 2023, at a cost of R21.36 billion, which is significantly higher than the R10.03 billion spent in 2022 financial year. The variance is mainly due to higher than budgeted volumes (1 551GWh above plan) and price variances.
- Eskom continues to experience challenges with their relative particulate emissions, By March 2022, 13 units were operating in non-compliance with average monthly emission limits (March 2022: eight units). This placed 7 691MW at risk of being shut down by the authorities (March 2022: 4 766MW).

ESKOM COMPLIANCE WITH EQUITY CONDITIONS

- For 2022/23, 24 conditions that are attached to the equity allocation have been imposed on Eskom which are clustered as follows:
  - **Financial conditions**: 13
  - **Operational conditions**: 9
  - **Restructuring conditions**: 1
  - **General:** 1
- In reviewing compliance with these conditions, National Treasury considers areas where Eskom fully complied, not complied and partially complied with the required information:
  - Fully complied means that all the required information was provided.
  - Not complied means the information was not provided or dates were not met.
  - 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.
- As at 31 March 2023, Eskom complied with all these conditions and provided the required information, and where further investigations and approvals are required, Eskom provides the best available information.

SOUTH AFRICAN POST OFFICE (SAPO)

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SOUTH AFRICAN POST OFFICE

Background

- SAPO has historically struggled with defining its strategic role as a commercial enterprise, operating within a rapidly changing ICT environment, whilst balancing its distinct developmental mandate.
- SAPO has been in financial decline for a decade as it is struggling to address its structural challenges in a modern economy.
- Although a number of reforms have been implemented and SAPO's mandate was strengthened to provide the basis for its turnaround, the entity continues to struggle with its commercial revenues due to the failure of the board (current and previous) to successfully implement turn around strategies.
- SAPO in consultation with DCDT have finalised SAPOs new strategy (The Post Office of tomorrow) which aims to turn the business around in light of the technological changes that had forced the entity to lag behind.
- The DCDT has also developed a draft postal services market study that seeks to determine the economic viability and need for SAPOs services in a changing postal landscape.
- These studies need to be aligned to ensure funding the continuation of SAPO operations does not lead to loss of funds due to misallocation towards non-revenue generating activities.
- The DCDT needs to urgently finalise and publish the postal services market study to determine the future role of SAPO in the postal sector.
- It is important to note that the implementation of the new strategy has commenced, however it remains challenged due to the lack of funding on key projects which underpins the strategy.

SOUTH AFRICAN POST OFFICE…2

Financial Update as at 31 March 2023

- Revenue of R2.6 billion for the year is 46% underbudget due to failure to implement revenue initiatives, increased customer migration to digital alternatives, and the weak financial position of SAPO impacting its ability to pay suppliers
- Expenses of R5.1 billion are 24% underbudget. However, due to SAPO's high fixed cost structure, expenses continue to exceed revenue. Staff costs of R3.6 billion for the year contribute 70% of the total cost.
- The poor revenue performance has resulted in SAPO forecasting a net loss for the year of R2.1 billion despite SAPO's USO mandate being funded (USO subsidy – R452 million).
- SAPO's financial position continues to be severely constrained resulting in SAPO being commercially insolvent and illiquid.
- SAPO creditors amount to R5 billion as of 31 March 2023 with statutory obligations amounting to R2.4 billion. Included in the statutory obligations is R1.1 billion due to Post Office Retirement Fund, R539 million to SARS, R596 million to Medipos, and R108 million to UIF.
- No government guarantees are currently in place for SAPO.
- SAPO has been recapitalised with R2.4 billion prior to the entity receiving provisional liquidation order.
- The DCDT has developed a strategy to deal with the provisional liquidation which has been submitted to cabinet for consideration. The plan is intended to form part of the response to the Court Judgement and will be tabled in court on 01 June 2023.

DENEL

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STAY SAFE
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DENEL

Background

- Due to ongoing challenges, Denel was historically unable to meet some financial commitments i.e., creditor and salary payments, tax duties and guarantee obligations (resulting in Government stepping-in for guaranteed debt totalling R3.241 billion to date).
- During 2021, Denel revised its strategy with a new turnaround plan. This comprises of disposing non-core assets, consolidating core capabilities, and achieving growth through collaboration, amongst others. The implementation of the turnaround plan requires ongoing consultation and agreement with stakeholders on the disposal of non-core assets.
- The turnaround plan has a funding requirement of R5.203 billion, of which Denel committed to raise circa R1.8 billion through the disposal of identified non-core assets. Therefore, it was announced during the 2022/23 Medium-Term Budget Policy Statement (MTBPS) that Denel will be allocated R3.378 billion, subject to meeting certain pre- and post-disbursement conditions and a Special Appropriation Act, 2022 was finalised.
- During March 2023, Government disbursed the R3.378 billion. However, Denel was only allowed to immediately access a portion totalling R1.863 billion, accounting for 55% of the proceeds realised through the sale of its non-core assets (R992 million of R1.8 billion).
- The remaining portion is required to be ringfenced by Denel and only drawn down when the entity realises proceeds from the sale of the remaining non-core assets. This enforces accountability on Denel to follow-through on the identified self-help initiatives to augment the recapitalisation.

DENEL….2

Financial performance as at 31 March 2023

- Denel has not been submitting audited annual reports, owing to the historical challenges experienced. However, the entity has been regularly submitting quarterly reports.
- To date, Denel has received the funds received from the Denel Medical Benefit Trust (DMBT) disposal transaction amounting to R992 million (as part of its turnaround plan).
- Owing to this, and the receipt of a portion of the appropriation, Denel's equity was reported at R2.2 billion and its liquidity stood at R3.7 billion as at 31 March 2023. This is a significant improvement from the historically negative equity being reported.
- Denel forecasts reduced net losses (-R267 million against a budget of -R991 million) due to the DMBT proceeds. Profitability was suppressed due to reduced productivity in operations, associated under-recoveries and delays in the implementation of cost reduction measures.
- Whilst Government assistance reduced Denel's guaranteed debt and boosted its equity, Denel remains financially vulnerable. Delivering on the turnaround plan remains priority.
- Other disposal initiatives are in progress. The Denel Gear Ratio transaction received PFMA approvals and awaits the receipt of R94 million. The Hensoldt share disposal is awaiting Ministerial PFMA approvals to unlock R175 million. The property disposals received offers and due diligence is undertaken with potential buyers to unlock R650 million.
- NT continues to monitor progress on Denel's turnaround plan and will review the PFMA applications still to be received on the identified property disposals.

SOUTH AFRICAN AIRWAYS (SAA)

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SOUTH AFRICAN AIRWAYS (SAA)

Background

- On 30 September 2020, Cabinet approved that R10.5 billion be allocated to SAA in the Second Adjustments Appropriation Act 2020 (Act No.21 of 2020) for the implementation of the business rescue plan.
- However, the Second Adjustments Appropriation Act specifically and exclusively earmarked the entire R10.5 billion for the implementation of SAA's business rescue plan. Hence, the R2.7 billion could not be transferred to the SAA subsidiaries since the subsidiaries were not under business rescue.
- The Special Appropriation Act provided the following funding 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.
- NT was requested to provide quarterly updates to Parliament on the utilization of the R2.7 billion allocation to SAA subsidiaries.
- The R2.7 billion allocation to SAA subsidiaries forms part of the R10.5 billion that was allocated to SAA during the 2020 MTBPS.

SOUTH AFRICAN AIRWAYS (SAA)…2

- SAA is no longer technically insolvent. The Net Equity Value as at 31 March 2023 amounted to R670 million.
- The SAA Group ended March 2023 with unaudited YTD profit of R500 million against a budgeted loss of R740 million. This profit comprises of SAA R31 million, Air Chefs loss of (R12,6 million), SAAT R84,4 million, Mango loss of (R66 million) and consolidation entries R505 million.

South African Airways Technical (SAAT)

- The full R1.663 billion allocated to SAAT has been transferred to the entity and utilized as follows:
  - R704.2 million was used to pay long outstanding salaries to employees for the period September 2020 to July 2021.
  - R79 million for the purchase of spares.
  - R879 million for the completion of the restructuring process and working capital for the business.

Air Chefs

- The full R218 million has been transferred to Air Chefs and has been utilized as follows:
  - R107 million for the payment of employee salaries for the period April 2020 to July 2021.
  - R111 million for the restructuring of Air Chefs.
- Although loss-making, the company's financial performance has improved when compared with prior years.

SOUTH AFRICAN AIRWAYS (SAA)…3

Mango

- On 10 August 2021, the South Gauteng High Court granted the Board of Directors' application to place Mango under voluntary business rescue.
- The Business rescue plan was subsequently published on 29 October 2021.
- Of the R819 million which was allocated to Mango as part of the R2.7 billion Special Appropriation Bill, the DPE disbursed R420 million for salaries, developing a business rescue plan and Voluntary Severance Packages (VSPs).
- The remaining R399 million was transferred on 31 March 2021 for restructuring/business rescue.
- Mango Business rescue process has gone beyond the target exit time of May 2022.
- Mango's Business Rescue Practitioner is focusing on securing a Strategic Equity Partner.
- National Treasury received a section 54(2)(c) PFMA application from SAA on 30 September 2022 requesting approval to dispose of SAA's 100% shareholding in Mango to Ubuntu.
- The BRP subsequently filed an application in the High Court against the Minister of Public Enterprises and others for the Minister to provide a decision on the PFMA Section 54 application.

TRANSNET

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TRANSNET

- Transnet Freight Rail operations have been negatively impacted by ongoing security incidents, locomotive unavailability and the poor state of the rail infrastructure.
- Inefficiencies of the Transnet's freight rail network poses a significant risk to the South African economy and requires urgent intervention.
- The decline in freight rail is a result of a confluence of factors which amongst others include:
  - Operational inefficiencies;
  - Theft and vandalism; and
  - Underinvestment in the network
- Port productivity is significantly lower than benchmark African and European ports (as per published studies). Maintenance of critical equipment is the main contributor as the port of Durban seldom has higher than 60% availability of container equipment.
- One of the conditions attached to funding provided to Transnet in 2022/23 is that an independent review let by the National Treasury of all freight corridors and associated port operations will be undertaken with a specific focus on identifying opportunities for operational efficiency improvements.

Thank You