PRESENTATION TO STANDING COMMITTEE ON APPROPRIATIONS

Update on State Owned Companies Q1 (Apr tp June 2023)

PRESENTED BY:

Asset and Liability Management Division

Date: 29 August 2023

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

STAY SAFE

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LAND BANK

LAND BANK

- The Land Bank has been in default since 01 April 2020 and since then, three versions of the liability solution have been rejected by the lenders of the Land Bank.
- The Land Bank is still trying to conclude and implement the liability solution Version 4 with its lenders to cure the default position.
- The Land Bank established an escrow account where in the R5 billion was transferred to protect the fiscal allocation from being accessed by the lenders of the Land Bank.
- R5.1 billion of the R7 billion recapitalisation is still kept in the escrow account until the Land Bank meets the equity conditions attached to the R5 billion, failing which the equity would be transferred back to the National Revenue Fund.
- National Treasury is currently processing the full repayment of the last two guaranteed lenders of the Land Bank from the R1 billion set to flow to the Land Bank in 2023/24.
- The remainder of the R1 billion after repaying the last two lenders would be transferred to the Land Bank for utilisation in the Blended Finance programme of the Land Bank.

LAND BANK

- The Land Bank received an unqualified audit opinion with findings for the 2022/23 financial year, following a clean audit opinion in the 2021/22 financial year due to the implementation of the remedial plan.
- The Land Bank is currently working on developing a business case for the funding model of the entity to align with the mandate and policy objectives of the Land Bank.
- The Land Bank has developed a Land Bank Development Indicator Framework (LBDIF) in order to improve the Bank’s reporting on development indicators.
- The Land Bank is currently working on finalising a business case for the blended finance model of the Land Bank which is envisioned to utilise at least R3 billion of the equity allocation to the Land Bank.

LAND BANK: FINANCIAL UPDATE

- As at end of Quarter 1 (30 June 2023), Land Bank recorded a profit of R135 million against a budgeted loss of R80 million and a Prior Year (PY) loss of R92 million for the quarter. This is mainly due to higher net impairment charges of R170 million, up R210 million from prior year's R40 million release. This is a result of the increase in the number of days in arrears of existing NPL book which has resulted in the Bank holding higher ECL.

- Land Bank generated net interest income of R101 million, which is R44 million lower than the budget of R145 million and R18 million higher than the prior year's amount of R83 million mainly due to the increase in cash balances and increase in interest rates.

- The Group's operating expenses of R122 million are down R10 million compared to PY mainly due to reduced personnel costs due to unfilled vacancies, lower restructuring expenses, professional fees, Property and equipment repairs and maintenance.

- Funding Liabilities decreased to R17.1 billion (31 March 2023: R22.5 billion) due to capital and interest repayments of R5.4 billion during the year.

- Net loans and advances decreased to R14.4 billion from the R15.1 billion reported at 31 March 2023. The main contributor is the reducing loan book (R419 million) from R18.8 billion to R18.4 billion; owing to restricted disbursements and client settlements as well as the increase in the ECL.

- The non-performing loan portfolio has grown from R9.7 billion to R9.9 billion, resulting in an increased NPL ratio of 53.6% (March 2023: 51.5%). The NPL strategy is being augmented with new initiatives in an attempt to preserve the book from further deterioration.

ESKOM

ESKOM: FINANCIAL UPDATE

- Eskom's unaudited first quarter (Q1) performance of 2023/24 reported the following
  - A loss before tax of R5 billion.
  - Net revenue grew to R70.9 billion (June 2022: R66.3 billion), largely driven by a regulatory standard tariff increase of 18.65% for Eskom's direct customers from 1 April 2023.
  - Total invoiced municipal arrear debt increased to R63.7 billion as at 30 June 2023 (March 2023: R58.5 billion) which continues to negatively affect Eskom's profitability.
  - Sales volumes were 3TWh (6.2%) lower than budget and declined by 3.4TWh (7%) when compared to the same period in the previous financial year. Sales volumes were impacted by generation supply constraints, leading to load curtailment and loadshedding.
  - Primary energy costs of R43.4 billion was R3.5 billion (7.4%) lower than budget, mainly due to expenditure on Eskom Open Cycle Gas Turbines (OCGTs) being 19.3% lower than budget. The lower than budget spend was largely driven by a favourable decline in diesel prices during the quarter.
  - Gross debt securities and borrowings increased to R453.5 billion as at 30 June 2023 (March 2023: R439.1 billion). Eskom raised R16 billion in funding through private placements on 31 March 2023, with the related disbursements only taking place in early April 2023.
  - Financial profitability ratios performed better than target for the period, however Eskom is still experiencing several challenges that prevent it from achieving long-term financial sustainability.
  - Cash interest cover and debt service cover ratios of 1.17 and 0.45 respectively 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 continued need for Government support.
- Eskom's profitability remains hampered by poor long-term financial sustainability arising from an inadequate tariff path, poor generating plant performance, escalating arrear municipal debt as well as high debt servicing costs.
- Eskom has utilised R342 billion (98%) of the R350 billion Government guarantees through the Guarantee Framework Agreement which expired on 31 March 2023.

ESKOM: OPERATIONAL CHALLENGES

- Eskom's Energy Availability Factor (EAF) reported at 54.49%, as at 30 June 2023 (March 2023: 56.03%) continues to decline steadily, and significantly worse than the proposed target of 65%. The decrease in EAF compared to the previous year is largely due to an increase in unplanned losses (UCLF) to 34.97% (March 2023: 31.92%).
- During Q1, average unplanned unavailability was 16 718MW, higher than the Winter Plan's base-case assumption of 15 000MW, resulting in loadshedding ranging from stage 2 to stage 6 on 91 days during the quarter.
- Eskom continues to experience an increase in partial and full load losses, which contribute significantly to the high UCLF. Partial load losses continue to increase reported at 6 927MW (March 2023: 6 057MW). The increase in partial and full load losses contribute significantly to the high UCLF.
- Coal-fired stations recorded an average energy utilisation factor (EUF) of 96.27% for the period, with EUF over 90% at all 14 coal-fired stations and substantially above the international norm which is expected to average around 75% considering the age of Eskom's fleet.
- Eskom and Independent Power Producer's OCGTs continued to be utilised frequently during the past quarter to support the power system and limit the stages of loadshedding. Eskom and IPP OCGTs generated 1 583GWh during the quarter, at loads factors of 24.2% and 22.3% respectively.
- Relative particulate emissions performance has seen further deterioration to 1.01kg/MWh sent out, substantially worse than target (June 2022: 0.40kg/MWh sent out). This is significantly worse than the performance recorded prior to the implementation of emission upgrades at stations like Duvha, Matla, Matimba and Lethabo. Kendal continuous to contribute significantly to the poor performance, with the station contributing half of the total emitted particulate matter within Generation.
- By March 2023, 17 units were operating in non-compliance with average monthly emission limits (March 2023: 13 units). This placed 10 206MW at risk of being shut down by the authorities (March 2023: 7 691MW).

ESKOM DEBT RELIEF ACT

- In the February 2023 Budget Speech, the Minister of Finance (Minister) announced a debt relief package for Eskom.
- The Eskom Debt Relief Act (the Act) was assented by the President on 06 July 2023 and published in the Government Gazette on 7 July 2023. Under the Act, Eskom will receive support for debt servicing of R254 billion over the next three years.
- The first component of the support will provide direct support of R184 billion to address Eskom's debt and interest payments as they fall due, with R78 billion in 2024, R66 billion in 2025 and R40 billion in 2026.
- The second component entails Government taking over R70 billion in Eskom debt commitments (both capital and interest payments) in 2026.
- This support will initially take the form of an interest-free subordinated loan, which will be settled in ordinary shares on a quarterly basis once Eskom has demonstrated, to the Minister's satisfaction, that it has complied with the conditions attached to the support.
- A monitoring committee comprising National Treasury, Department of Public Enterprises and Eskom will on a quarterly basis monitor Eskom's progress in complying with the implementation of the conditions and make recommendations to the Minister regarding the conversion of the loan to equity.
- Failure by Eskom to demonstrate compliance will result in the delay in the conversion of the loan (or part thereof) until the next quarterly meeting, where compliance will be reassessed again. Thereafter, non-compliance with the conditions will result in Eskom having to repay the loan to the National Revenue Fund at market rates.
- Eskom will begin to report on the conditions attached as at 30 September 2023 and these were formally communicated to the Eskom Board Chairperson by the Minister on 31 July 2023

CONDITIONS FOR ESKOM DETERMINED BY MINISTER OF FINANCE IN TERMS OF SECTION 2(2)(b) OF ESKOM DEBT RELIEF ACT, 2023

The following conditions apply from 01 August 2023 until 31 March 2026, and as amended, by the Minister of Finance from time to time:

1. The debt relief envisaged in the Eskom Debt Relief Act, 2023, may only be used to settle debt and interest payments.
2. Eskom may only incur capital expenditure for transmission and distribution except for—
   a. generation regarding minimum emissions standards, flue-gas desulfurisation and required outages and maintenance of existing plant; and
   b. a greenfield generation project with the written approval of the Minister of Finance.
3. All net cash proceeds from the sale of non-core assets, including the Eskom Finance Company and any property sales, may only be used to settle debt and interest payments.
4. Eskom may only borrow new facilities with the written approval of the Minister of Finance.
5. The Eskom's guarantee framework agreement, entered into by the Minister of Finance and Eskom, for the R350 billion facility (which expired on 31 March 2023) must, subject to the terms of that agreement, be reduced as the relevant redemptions fall due.
6. Positive equity balances in Eskom's derivative contracts such as swaps and hedges or any other finance contract, may not be used to structure new debt or loan agreements or use any such balance as "margin financing" for another derivative contract or derivative overlays, without the written approval of the Minister of Finance.
7. Eskom must continue to prioritise and expedite the implementation of the unbundling process, including, for example, obtaining lender consent to fully implement unbundling.
8. Eskom may not implement remuneration adjustments that negatively affect its overall financial position and sustainability.
9. Any transaction undertaken in terms of section 54 of the Public Finance Management Act, 1999, must be subject to joint approval by the Minister of Public Enterprises (MoPE) and the Minister of Finance.

SOUTH AFRICAN AIRWAYS (SAA)

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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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 utilisation 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)

Additional allocations

- In addition to the R10.5 billion allocated for the implementation of the business rescue plan, the Minister of Finance allocated R1 billion in the February 2023 budget for the settlement of outstanding business rescue obligations.
- The allocation to SAA was subject to several conditions which the airline has made progress regarding compliance:

i. Funds are specifically and exclusively appropriated to settle outstanding business rescue plan obligations;

ii. All government guarantees to SAA will be cancelled upon disbursement of funds;

iii. Takatso Consortium, to provide proof of funds for the Strategic Equity Partnership (SEP) transaction prior to its conclusion;

iv. National Treasury will conduct a review of the SEP agreement to ensure it does not give rise to future fiscal obligations;

v. SAA will continue to identify and dispose of non-core assets including implementing sustainable cost cutting initiatives which must be included in the monthly reports to the National Treasury;

vi. No incentive bonus pay-outs to executives during the period prior to the conclusion of the SEP transaction;

vii. The Shareholder Compact must be finalised in consultation with the Minister of Finance, before it is approved; and

viii. Within 30 days after the end of each month, SAA should provide monthly updates which must include, inter alia, forecast cash flows, revenue generation, profit and loss statement, statement of financial position.

SOUTH AFRICAN AIRWAYS (SAA)

Financial update: as at 30 June 2023

- SAA Group budgeted a loss of R182 million, while it reported a lower loss of R150 million.
- The Group loss consist of losses reported in SAA, Air Chefs and Mango, while SAAT reported a profit of R4.4 million.
- Group revenue of R1.1 billion was 22% less than the budgeted R1.4 billion. This is due to the lower average load factor for Q1 of 60% for domestic travel and 49% for regional travel. Furthermore, in June SAA cancelled flights due to aircraft maintenance and no spare aircraft available. The entity underspent by 25% on operational expenses, however, the cost incurred were still higher than revenue earned.
- Operating costs were R17 million. Reasons for increased operating costs were:
  - R2.6 million SARS penalty for late submission, not budgeted for
  - Labour cost R5.2 million higher than budget
  - Material cost R14.6 million higher than budget due to subcontracting costs and freight charges
  - However, energy cost were R4.7 million below budget.
- Mango has been under voluntary business rescue since July 2021 and it has not flown ever since. This subsidiary made a loss of R9 000 in Q1, and this is an improvement in relation to the loss made in the prior year's Q1 of R101 000. The decline in losses is as a result of reduction in operating costs.
- Air Chefs generates approximately 80% of its revenue from the SAA and supplied in-flight catering to Mango (in Durban) as well. The entity realized a loss of R1 million, mainly due to expenses in excess of the budget. Net losses showed an improvement compared to PY Q1 losses of R4million.

TRANSNET

national treasury
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REPUBLIC OF SOUTH AFRICA

2030 NDP

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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 as 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 led by the National Treasury of all freight corridors will be undertaken with a specific focus on identifying opportunities for operational efficiency improvements.
- The RFP for the independent review has been issued with a closing date of 15 September 2023.

TRANSNET

Financial update: as at 30 June 2023

- Transnet's overall performance for the period has deteriorated in all the critical commodity segments and business flows not achieving the targets set in the 2023/24 Corporate Plan.
- Rail volumes for the period were 18.2% behind the target due to commodities not meeting their budgeted targets (export coal line, iron ore, the manganese, chrome and magnetite) .
- Container volumes handled by the ports were 2.2% lower than budget, and pipeline volumes 25% below budget.
- The decline in the performance in Freight Rail is due to several factors amongst others, including:
  - Ongoing security concerns,
  - Locomotive failures and undersupply,
  - Continuous power failures at the mines, vandalism and community disputes,
  - And operational inefficiencies
- The underperformance in Ports is as a result of operational inefficiencies which are at times exacerbated by adverse weather conditions resulting critical equipment breakdowns.
- The underperformance in Pipeline is due to Natref shutdown and lower export allocation.
- The above performance resulted in Group revenue 13,8% below budget and 4,7% below the same period in the prior year, whilst Group EBITDA was 18,3% below budget and 5,5% lower compared to the prior year period.

SOUTH AFRICAN POST OFFICE (SAPO)

national treasury
Department:
National Treasury
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SOUTH AFRICAN POST OFFICE

Background

- SAPO was placed in provisional liquidation by an order of Court on 9 February 2023 following a successful application by a group of creditors.
- The provisional liquidation was as result of SAPO being unable to pay its debts to creditors to continue operations.
- Cabinet approved that SAPO be placed under voluntary business rescue based on the DCDT's business continuity report. A business rescue specialist has been appointed and has commenced work with the SAPO.
- The business rescue option is primarily premised on supporting SAPO to implement the Post Office of Tomorrow Strategy.
- A monitoring task team has been established comprising of DCDT, National Treasury and SAPO monitor progress of the business rescue process.
- SAPO was recapitalised with R2.4 billion for the implementation of the Post Office of Tomorrow Strategy. This was prior to the entity receiving provisional liquidation order.

SOUTH AFRICAN POST OFFICE

CONDITIONS TO THE R2.4 BILLION ALLOCATION

- SAPO to submit to National Treasury and DCDT all the reports that have been produced in relation to financial misconduct. SAPO to also submit reports from 1 April 2019 to Q3 2022/23 on how the people who were identified as being responsible for such misconduct have been dealt with by 31 December 2023.
- SAPO to provide confirmation that no bonus payments and salary increases will be implemented including historical commitments, while the entity is receiving government recapitalisation funding.
- SAPO must provide a detailed report on the causes of the financial collapse of the entity (both internal and external factors) and explain why the previous turnaround plans have failed to be successfully implemented.
- The R2.4 billion should be used as part of the business rescue process if granted by the court.
- DCDT to appoint an independent valuator to evaluate all the property listed by SAPO for disposal prior to disposal and provide progress report on the appointment process by 15 September 2023 and conclude the process by 31 December 2023.

SOUTH AFRICAN POST OFFICE

Financial Update

- SAPO's Q1 2023/24 performance is before the commencement of the business rescue practitioner which was appointed in July 2023.
- Revenue generated of R482.8 million was R86.1 million (15%) below budget and R145.5 million (15%) below prior year's year to date (YTD). The reasons for the underperformance were among others branch closures, loadshedding and suppliers suspending their services due to non-payment.
- Operating expenses for the quarter amount to R964.1 million which is R329.4 million (25%) below budget and a year-on-year decrease of R385.6 million (29%).
- While operating costs are reducing due to stringent cost containment measures being implemented by SAPO, it continues to exceed revenue with staff costs being the main contributor to the high operating expenses. Cost containment measures included negotiating better sq/m rates on rentals, implementing voluntary severance packages and reducing security costs by moving the cash payment points for SASSA to Post Bank.
- SAPO generated a net loss for the quarter of R367.3 million against a projected net loss of R610.5 million and is also lower than the prior year's net loss of R608.4 million. Despite SAPO performing better than budget, it is primarily due to below budget expenses for the quarter and not due to improved revenue generation. The cost-to-income ratio for the quarter was 199.7% indicating the unsustainable cost structure of SAPO.
- SAPO had 1 024 operational branches as at 30 June 2023, of which only 10.2% are profitable.
- As at 30 June 2023, SAPO's outstanding liabilities was R4.7 billion. A further amount of R3.9 billion is owed to Postbank.
- No government guarantees are currently in place for SAPO.

DENEL

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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DENEL

Background

- Denel was historically unable to meet some of its financial commitments i.e., creditor and salary payments, tax duties and debt obligations (resulting in Government stepping-in for guaranteed debt totalling R3.241 billion to date) despite recapitalisations and government guarantees provided.
- Denel's new turnaround plan comprises of disposing non-core assets, consolidating core capabilities, and achieving growth through collaboration, amongst others..
- 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 (18 of 2022) was finalised.
- In March 2023, even though the R3.378 billion allocation was disbursed, only 55% was made available to Denel as it reflected the proceeds realised through the sale of non-core assets (R992 million of R1.8 billion). The remaining portion of the allocated funds is still being ringfenced by Denel and only to be drawn down when realising proceeds from the sale of the remaining non-core assets. This enforces accountability on Denel to follow-through on these augmenting initiatives.
- To date, Denel has been unable to finalise any other asset-disposal apart from unlocking the surplus funds from the Denel Medical Benefit Trust (DMBT). However, this is also a result of stakeholder misalignment in the defence industry, given that the anticipated Memorandum of Co-operation (MoC) to outline alignment on the identified sovereign and strategic capabilities, including the funding thereof, has been delayed and still not finalised to date.
- Despite the delays being experienced, National Treasury maintains that Denel needs to realise proceeds from the sale of non-core assets before the ringfenced portion of the recapitalisation can be accessed. Should Denel deem any of the identified initiatives to be compromised, considering it beneficial to opt for other asset-disposals to replace the value of those indicated in its turnaround plan, formal correspondence must be submitted to re-assess the drawdown schedule.

DENEL

Financial performance as at 30 June 2023

- As at 30 June 2023, Denel reported that the received portion of the recapitalisation was utilised towards paying obligations owed to the South African Revenue Service (SARS); restructuring costs; working capital; a bank overdraft; and settling legacy obligations. Only R262 million thereof remains to be utilised. That said, another R1.537 billion of the recapitalisation is being ringfenced by Denel and only to be drawn down when realising proceeds from asset-disposals.
- Denel's Earnings Before Interest and Tax (EBIT) worsened to R172 million compared to the projected R139 million, mainly owing to lower-than-expected revenue whilst costs remained relatively constant.
- Consequently, net losses deteriorated further than expected. As at 30 June 2023, Denel's realised net loss amounted to R206 million, which is 11.6% worse than the projected R182 million in losses.
- Denel still has two government guarantees in place. However, the one guarantee was never utilised owing to the Egypt contract being cancelled, and the other guarantee has been overtaken by Denel's turnaround plan in addition to it expiring in September 2023.
- Both guarantees will be removed after September 2023, once the remaining debt obligation matures. Denel will not be able to repurpose these guarantees and government's contingent liabilities will be subsequently reduced.
- Denel remains financially vulnerable. Delivering on the turnaround plan remains priority and Denel is consistently urged to finalise its asset-disposal initiatives.

Thank You