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An Analysis of Eskom's annual report for the past three financial years.

1. Introduction.

Eskom is one of the nine state-owned enterprises under the aegis of the Department of Public Enterprises. The entity was established in 1923 as the Electricity Supply Kommission as a result of the Electricity Act (No. 42 of 1922) and was converted into a public company in 2000 in terms of the Companies Act (Act 61 of 1973) with the State as the sole shareholder. As a public entity owned by the state, Eskom is obliged by legislation (PFMA, Act 1 of 1999) to submit its annual report to parliament for scrutiny. The rationale behind this exercise is to assess how entities listed on schedule 2 (major public entities) in the PFMA[1] utilise their (financial) resources to sustain themselves and to enhance government objectives as mandated by their respective departments.

The paper takes a close look at Eskom's annual report for the past financial three years. The focus is on how the state-owned enterprise has performed during these past three years. The analysis of the report goes further by looking at how the entity has managed to reconcile its objectives which are market driven with those of the state whose emphasis is on service delivery and economic growth.

2. Eskom's Vision.[2]

Together building the powerbase for sustainable growth and development.

3. Eskom's Mission.[3]

Planning for the future, building South Africa's economy.

4. Government Strategy.

Government's strategy on public entities like Eskom can be drawn from amongst other sources, the President's State of The Nation's address delivered each financial year. Early in 2006 the President in his address referred to Eskom's activities and operations as geared to "meet the demand for electricity [...]."[4] In 2007 the President once again called upon the entity to "ensure greater reliance on nuclear power generation, natural gas and various forms of renewable sources of energy."[5] In 2008 the President called upon the Department of Public Enterprises and through its various SOEs to work through public-private partnerships to make large investments in various sectors of the South African

[1] Public Finance Management (Act 1 of 1999).
[2] Eskom (2008), Annual Report.
[3] Ibid.
[4] Mbeki, T (2006).
[5] Mbeki, T (2007).

economy.[6] For the financial year under review Eskom is expected to roll-out its infrastructural build programme to increase capacity and secure energy supply for the country's economic growth.

5. Eskom's Key Strategic Objectives.[7]

Eskom's strategic objectives are linked to its new vision, namely "building the powerbase for sustainable growth and development." The strategies are;

- Quality and continuity of supply.
- Capacity expansion.
- Funding and financial resourcing.

In response to the challenges Eskom faced as a result of electricity supply demands, energy price increases and credit approval, the entity in 2008 modified its strategic objectives to read as follows;[8]

- Securing continuity of supply- the recovery plan
- Successfully executing the build programme
- Responding to climate change
- Maintaining financial sustainability
- Restoring public confidence
- Successfully implementing EDI restructuring

According to the utility's management, various initiatives will be implemented to facilitate these six strategic objectives and research and development will strengthen the entity's technical performance and expansion programme.[9] Importantly, these strategic objectives were adopted in cognisance of industry trends and changes both locally and abroad. Their implementation is within the framework of three key drives, namely economic, social and environmental considerations.

On the economic front Eskom intends to supply energy in order to eliminate poverty and stimulate the economy. Socially, the Group envisages to use its energy resources to make better the lives of millions of South Africans. All of this will be done with little or no harm to the environment and its people as Eskom continue to investigate alternative technologies for low impact on the environment.

6. Eskom new key appointments

6.1 New Chairman of Eskom's Board

Eskom has appointed Bobby Godsell, former Anglo-Gold Ashanti boss as the new Chairman of the Board. Included also in the list of new appointments is Ras Myburgh former Chief Executive of Kumba

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[6] Mbeki, T. (2007).
[7] Eskom (2005a) Strategic Plan 2005/08
[8] Eskom (2008), Annual Report.
[9] Eskom (2008), Annual Report.

Resources as an adviser to Eskom's long term coal sourcing strategy.[10] The strategy on the part of Eskom it would seem, will be to secure coal supply since both appointees have a strong background in the coal business.

6.2 Reserve margin

Power outages at the beginning of 2008 raised a number of questions about Eskom's viability in ensuring security of electricity supply. These questions ranged from Eskom's reserve margin, power generation capacity as well as maintenance issues. Mr Jacob Maroga, Eskom's CEO reported to the public that the power supply crisis was as a result of policy regulation and planning (failure to plan for power generation). This included unplanned outages and depleted coal stocks that tipped an already tight supply system.[11]

Eskom's net reserve margin had decreased to about 8% compared to an international accepted margin of 15%. A report compiled by the Centre for Development and Enterprise points out three important factors responsible for Eskom successful security of supply demand;[12]

- The first is to secure not only the supply of coal but its reliable transportation. The deterioration of the road and rail infrastructure must be reversed particularly one leading to Eskom's major power station in Mpumalanga.

- The second according to the CDE report is the co-generation projects with private sector power producers. Without private sector participation, according to the CDE lights will be going out for hours every day by 2010 and the country can abandon any hopes of reaching its growth targets.

- The third from the report is for Eskom to increase the price of electricity to fund production and induce more efficient use of electricity and therefore reduce pressure on the reserve margin while it is being improved.

6.3 Independent Power Producers (IPPs).

Eskom's cheap electricity prices have been criticised for discouraging private energy producers to enter the electricity market.[13] It is hoped that with Eskom's recent tariff hikes dating back to 2008 the private energy producers will be willing to enter the electricity market especially if the price of electricity will bring the expected returns.

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[10] Hazelhurt, E. (2008).
[11] Cokyane, R. (2008).
[12] Hazelhurt, E (2008).
[13] Donnelly, L. (2008).

6.4 Load shedding 2008/09

Following Eskom's energy crisis and power cuts, on February 4, 2008 government appealed to users to save about 10% (3000 Mega Watts) of the electricity to keep the demand under control.[14] This call seem to have only been heard by industrial users than residential users. Industrial customers who include mines and smelters account about 40 percent of electricity consumption and the rest by residents.

By April 2008 large industrial customers had saved about 1600MW and the rest of the country having saved only 400MW. This then prompted Eskom to re-initiate load shedding, which continued for several months to save the balance of 1000MW. According to Etzinger, Eskom's spokesman, " it was primarily industrial customers that were shouldering the burden of reduced supply."[15]

6.5 NERSA's recommendation on Eskom's tariff hikes

In granting Eskom's tariff increase of 27,5% in 2008 the National Electricity Regulator of South Africa (NERSA) recommended the following to Eskom's management:

- It must ensure that it has sufficient coal to carry it through unexpected events and high rainfall.
- It must explain delays in building new power plants and returning mothballed plants to service.
- It should make regular reports on progress on building new base load plants.
- It must critically review its system of coal planning and the allocation of accountability for any major variance in volume, mix and price.
- It should develop a plant management strategy to cope with low reserve margins in the next five years.
- A national strategy should be developed by the government to acquire and manage coal; and
- The decision to export beyond contractual obligations needs to be explained.

7. Government's role

The Chairman of the National Electricity Regulator of South Africa, Mr Thembani Bukula called on government to accelerate its lending to Eskom to R12 billion a year for five years instead of the R6 billion and R54 billion over four years.[16] According to Moody (credit rating agency) the nature of government's intervention (guarantee or cash loan) at Eskom would be a vital component of the agency's assessment of the entity.

Treasury responded by announcing that it will lend Eskom R60 billion over three years instead of the five years stated in the February budget speech.[17] The state will lend Eskom R10 billion in the year to

[14] Payne-Enslin, S (2008)
[15] Payne-Enslin, S. (2008).
[16] Brown, J (2008).
[17] Ibid.

next March, followed by R30 billion in the following year and a further R20 billion in the year to March 2011.

According to the Director General in the Treasury Department, Mr Lesetja Kganyago, "government will consider providing guarantees to enable Eskom to access funding otherwise not available."[18] He added; "Government is cognisant of Eskom's critical role in the economy and the importance of solid investment-grade credit rating, and thus remains committed to ensuring Eskom's financial stability. The terms and conditions of the loan according to Treasury have been designed to ensure that senior unsecured lenders are not prejudiced. Government's loan to Eskom can be paid at least over 20 years.

8. Eskom's borrowing strategy

In 2006 Eskom in its annual report reported that about R97 billion of its capacity programme will be funded largely from operational cash flows, commercial instruments and export credit agreements. The entity launched a seven-year 500 million euros, and in March 2008 Eskom registered a domestic R65 billion Multi-term Note Programme. By May 2006 the company securitised R1,6 billion of Eskom Finance company's mortgage book.

Despite these capital raising arrangements Eskom's low credit rating makes it difficult for the utility to raise enough capital for its build programme. In 2008 Eskom's credit status was downgraded by Moody's Investors Services to Baa2, a rating which according to Eskom's spokesperson has impaired the utility's ability to raise debt. The one option [illegible] is to increase its tariffs prices. **According to Eskom's Chief Executive Officer, Mr Jacob Maroga beyond increasing tariffs, Eskom's ability to raise funding *is* limited.**[20] **The utility is short of up to R132.6 billion for its R274.2 billion budgeted up to March 2012.**[21] For the financial year 2009/10 NERSA granted Eskom a price increase of **31.3%** of its tariffs with effect from 01 July 2009.[22]

According to Eskom's General Manager, Mr Andrew Etzinger 60% of the electricity produced by Eskom is sold directly to the consumer while 40% is sold to municipalities. Consequently, tariffs charged by each of the two suppliers differ, for example in the City of Cape Town 500kWh per month is billed at R324.27 and yet Eskom supplied house-holds pay R343.55. Durban eThekwini municipality users pay R290.40 for 500kWh and Eskom users pay R338.08.[23]

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18 Ibid

9. Financial performance

INCOME	2008/09	2007/08
Revenue (Loss)	R4-billion	R3, 8-billion
Profit for the year (Loss)	(R543,9-million)	(R347.2-million)
BALANCE SHEET	**2008/09**	**2007/08**
Equity and liabilities	R4, 9-billion	R5,1-billion
CASH FLOW	**2008/09**	**2007/08**
Operating activities	(R807,1-million)	R72-million
Investing activities	(R357,2-million)	R149,5-million
Financing activities	R892,6-million	R399.5-million

Eskom started the financial year March 2006 with a balance sheet (assets, equity and liabilities) of R138, 2-billion, and to date the entity's balance sheet is at R199,3-billion. Perhaps the reasons why Eskom's balance sheet has grown this much is because of the utility's capacity expansion programme which is financed through debt and equity. In the previous financial year Eskom's CEO, Mr Jacob Maroga warned of Eskom's precarious position in raising debt for its capital projects. He said, "[...] agencies like Standard and Poor's placed Eskom on credit watch," with negative implications on the entity's borrowing capabilities.[24] True to his words the entity's rating by Moody's credit agency went down to Baa2,[25] the second lowest investment grade, forcing the utility to further increase its tariffs by 31.3% as indicated in the previous section.

In terms of revenue, there has been a slight increase over the years from R39, 3-billion in 2007 to R53, 8-billion in 2009. However, profit for the year has deteriorated from R6 billion in 2006/07 to R9, 7-billion loss in 2008/09. Eskom's Board Chairman, Bobby Godsell advises that this loss must "[...] be seen in the context of the R30 billion spent on the built programme, R18 billion more than in the previous year."[26] In the 2007/08 financial year Eskom attributed its losses of R168 million to a number of factors including the rise in primary energy prices and load shedding. Primary energy costs (mainly coal and diesel) according to the utility increased from R13 040 million in 2007 to R18 314 million in 2008.[27] The higher primary energy cost that Eskom incurred in 2006/07 and 2007/8, together with projections for the 2008/9 financial year prompted the organisation to approach NERSA with the view to re-open tariff discussions for the 2008/09 financial year.

In terms of future projections particularly Eskom's build programme at the cost of R343 billion over five years. The utility will require significant contributions from all sources of capital namely price increases, funding support from government, and borrowings from both the local and international

[24] Maroga, J (2008).

[25] Wray, Q. (2008).

[26] Godsell, B. (2009) Chairman's Report.

[27] Moraga, J. (2008).

market. That is, if Eskom's five year build programmed is to be financially viable. The infrastructure expansion programme is budgeted at **R343 billion up to 2013 and is expected to grow to more than a trillion rand by 2026.**

10. Human Resource

Eskom has a total workforce of 5 067 excluding associated companies, of which 4 121 are employed on permanent basis and 946 are not contract.[28]

In 2006, 60.1% of Eskom's managers were black and blacks comprised 70% of Eskom overall staff profile. Women constituted about 31.8% at managerial level and 24% overall. In 2005 internal promotions have saw the rise among black staff from 75.3% to 78.1% in 2006. Conversely, the number of female promotions has declined from 44.4% in 2005 to 39.7% in 2006. Below is a summary of Eskom's equity figures as reported on its annual report for the financial year under review.

11. Staff profile

Looking at the utility's employment equity targets it would seem that Eskom's equity implementation process is running smoothly. As part of Eskom's transformational agenda, the utility commits itself to continue with the affirmative action drive, the promotion of women and people with disabilities.[29] On skill development, Eskom invested about R543m in 2006 for the development and training of its staff. By 2008 this figure had increased to R784 million for the total of about 35 404 of its employees. Areas of focus include leadership, technical and engineering categories as well as artisan. For the financial year under review Eskom has spent about R823, 5 million on training investments in accordance with individual development plans, to ensure optimal performance in the work environment.[30]

12. Auditors' opinion

From 2006 to date Eskom has received a clean audit for its financial statements. For the past two financial years Eskom's financial statements were audited by *PricewaterhouseCoopers*. In the current financial year ended 31 March 2008 Eskom's financial statement were audited by *KPMG* Inc. which also gave Eskom a clean audit. Again in the year under review (2008/09) Eskom received a clean audit as their financial statements presented fairly, in all material respects, the financial position of the company and of the group as at 31 March 2009.

13. Conclusion.

The financial year 2008/09 was the most challenging year for Eskom as a result of the energy supply shortages. Since then the utility embarked on a two-pronged strategic campaign, one of which was an energy saving campaign and the other that of raising capital for its build capacity expansion

[28] Denel (2009) Annual Report.
[29] Eskom (2009) Annual report.
[30] Ibid.

programme. The latter has indeed been the most challenging, particularly as some of that capital is expected to come from tariffs. As for the outages, the utility has managed the energy saving campaign very well, and has subsequently outlined its infrastructural expansion programme to boost its energy capacity to avoid similar occurrences. Eskom's major challenge for now going forward is to raise enough capital for its build programme. And provided enough capital is secured and adequate coal stocks maintained and the build programme construction is up and running, only then can government expect the utility to play its role in the country's economic development.

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