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An Analysis of Eskom's annual report for the 2010 financial year**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 Kommissie 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) of the PFMA utilise their (financial) resources to sustain themselves and to enhance government objectives as mandated by government.

The paper takes a close look at Eskom's annual report for 2010. The analysis goes further by looking at how the entity has managed to reconcile its objectives which are market driven and those of the state who put emphasis on service delivery and economic growth.

2. Eskom's Vision.¹

Together building the powerbase for sustainable growth and development

3. Eskom's Mission.²

Planning for the future, building South Africa's economy

4. Government Strategy.

Government's view is that reliable electricity supply is a prerequisite for stability and prosperity for the country and that it is Eskom's job to ensure that it can supply sufficient power to meet rising demand.³ Conversely, an ever-increasing demand for electricity in an expanding economy has brought the era of excess capacity to an end, forcing the utility to raise its tariff prices. Eskom's power stations are aging and refurbishment is necessary to extend their life spans and new constructions are required to avert long term electric supply shortages.

A further key focus on the part of government will be to gain greater recognition for State-owned enterprises as strategic instruments of industrial policy. This among other things means that SOEs' key programmes must be integrated into the broader industrial policy and economic cluster programme of the government both in terms of funding and policy support.⁴ The Minister of Finance,

¹ Eskom (2008), Annual Report.

² Ibid.

³ Public Enterprises (2007).



Mr Pravin Gordhan indicated earlier this year in his budget speech that the public sector aim to spend about R846 billion on its infrastructure programme. And that a significant portion of the infrastructure programme will be undertaken by state enterprises such as Eskom. Examples include Eskom's build programme of the Medupi and Kusile power stations and Ingula pump storage scheme.

5. Eskom's Key Strategic Objectives

Eskom's strategic objectives are linked to its new vision, namely "the path to recovery."⁵ Key strategic objectives for the utility include the following:

- Ensuring reliable supply of electricity to all South Africans
- Ensuring adequate future electricity supply for South Africa
- Supporting the developmental objectives of South Africa
- Ensuring business sustainability of Eskom

Eskom intends to ensure that its system operates in such way that it provides reliable supply of electricity to the country at appropriate costs i.e migrate to cost-reflective tariffs in line with the electricity pricing policy.⁶ The utility will also facilitate the implementation of Independent Power Producers (IPPs) within the industry while taking every care to ensure that associated risks are managed. Eskom will also continue to support the electricity supply and value chain of the economy by driving affirmative procurement and creating new jobs and industries through the capacity expansion programme.

Each year Eskom's engineers work toward increasing the entity's generation capacity and for the financial year under review the utility has a total generation capacity of 40 870 MegaWatts (MW) with 452 MW added in this financial year. Below is Eskom's total capacity and various forms of energy:

Table. 5 (a)

Type of Energy	2010	2009	2008
Coal-fired (MW)	34 658	34 294	33 566
Hydro electricity (MW)	600	600	600
Pumped storage (MW)	1 400	1 400	1 400
Gas turbine (MW)	2 409	2 409	1 378
Nuclear (MW)	1 800	1 800	1 800
Wind energy (MW)	3	3	3
TOTAL	40 870	40 506	38 747

⁴ Hogan, B. (2010) budget

⁵ Eskom (2010) Annual Report

⁶ Ibid



5.1 Transmission

Two of the utility's divisions namely, Transmission and Distribution are vital in Eskom's objectives of supplying reliable electricity to the country. For the utility to be able to maintain reliable electricity supply for the stability and prosperity of the country, Eskom needs to ensure that its transmission and distribution lines are able to operate smoothly without glitches, technical or maintenance faults. The average age of a plant in the transmission network is 32 years. The oldest substations and lines are 53 years old. This calls for high-level network plant and equipment maintenance and continual refurbishment and replacement of any plant that might have reached the end of its useful life.

However, the biggest challenge experienced in transmission is the issue of land and servitude acquisition. This relates to landowners expectations of the value of their land normally above the market price, sometimes resulting in a deadlock during negotiations. Due to the difficulty in acquiring servitudes on the following projects, Eskom has initiated the process of expropriating servitudes:

- The Mercury-Zeus 765kV line
- The Spitskop-Dinaledi 400kV; and
- The Mercury-Ferrum 499kV line

5.2 Distribution

To manage the retail business and optimally operate and maintain the Eskom distribution network, while playing an active role in the restructuring of the Electricity Distribution Industry (EDI),⁷ Eskom is continuing in its efforts to raise public awareness of generation and transmission capacity constraints and encouraging energy-saving behaviour through extensive communication campaigns and strengthening relationships with customers, municipalities and the public.

(a). The utility load manager

The Utility Load Manager (ULM) system is a demand-side management solution. This system can limit the load available to a residential premise on a real time basis. This reduction in load will be based on power reductions required to maintain the stability of the electricity network. Load reduction differs from other solutions as it gives customers a choice (which appliances to use and when) and basically encourages them to be energy efficient.

(b). Solar water heating

Eskom is embarking on a solar water heating programme to reduce the load associated with heating water, which is believed to be approximately 40% of total load for an average household. The programme is also in support of the government's drive to install one million solar water heating gysers over the next five years. Eskom has entered into partnership with the insurance industry to offer a solar water heating system as a water heating replacement option to their clients.

⁷ Eskom (2010) Annual Report



6. 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 (8% at the time), power generation capacity as well as maintenance issues. A report compiled by the Centre for Development and Enterprise pointed out to two important factors responsible for Eskom successful security of supply demand;⁸

- 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.

7. A summary of Eskom's financial performance

The financial turnaround resulted from the 31, 3% interim tariff increase granted by NERSA with effect from 1 July 2009, improved efficiencies and stringent cost cutting as well as the re-negotiation of certain of the special pricing agreements relating to the commodity-linked revenue contracts improved Eskom's financial performance for the year under review.⁹

INCOME	2009/10	2008/09	2007/08
Revenue	R71, 2-billion	R54, 1-billion	R44, 4-billion
Profit for the Year (Loss)	R3, 6-billion	(R9, 6-billion)	(R10, 1-billion)
BALANCE SHEET	2009/10	2008/09	2007/08
Equity & liabilities	R246, 1-billion	R199, 3-billion	R194, 6-billion
CASH FLOW	2009/10	2008/09	2007/08
Operating activities	R11, 6-billion	R11, 7 billion	(R1, 9-billion)
Investing activities	(R48, 9-billion)	(R42, 9-billion)	(R22, 9-billion)
Financing activities	R34, 3-billion	R38, 8-billion	R26,1-billion

The Company's revenue increased to R54, 1-billion from 2009 to R71, 2-billion in 2010 as a result of a combination of factors namely, the sale of electricity (increased by 1, 7%) resulting in electricity revenue to increase by 31, 8%. The Company posted a profit of R3, 6-billion for the financial year

⁸ Hazelhurt, E (2008).

⁹ Eskom (2010) Annual Report



under review compared to a R9, 6-billion loss in the previous financial year. About R2, 2-billion of this amount came from Eskom's contracts with the energy-intensive group industries. These are contracts the utility entered into with energy-intensive groups (smelters), and the contracts vary from one year to 18 years.¹⁰ The implication is that the contracts have a huge impact on Eskom's financial performance especially when one considers the following two factors:

- In the previous financial year Eskom made a loss of R9, 5-billion mainly as a result of the contracts with the energy-intensive industries (smelters).
- In the financial year under review the Group made a profit of R2, 2-billion from the same contracts boosting its net profit for the year to R3, 6-billion.

It looks like Eskom's 'path to recovery' will be much more improved in the next financial year as a result of renegotiation of certain special pricing agreements (SPAs) with some of the energy-intensive users. The cost of primary energy as a percentage of electricity revenue decreased from 47% in 2009 to 41,7% in 2010. Eskom has been able to secure short-to medium term coal supplies at lower prices than in the previous financial year and the utility also made more use of their fixed cost plus contracts. In addition, the more expensive gas and liquid fuel turbine stations were operated at normal levels.

Eskom's financial position as of 31st March 2009 was R199, 3-billion in terms of assets (equity and liabilities). By the end of the 2010 financial year the utility's balance sheet had increased to R246, 1 billion.

8. Eskom's funding challenges

Treasury announced in 2009 that it will lend Eskom R60 billion over three years instead of the five years stated in the February budget speech.¹¹ The state will lend Eskom R10 billion in the year to next March, followed by R30 billion in the following year and a further R20 billion in the year to March 2011. The utility has a government debt guarantee of R176 billion and has already spent about R117 billion and now with a balance of R59 billion. Eskom has also secured a World Bank loan of R28 billion. Despite these initiatives Eskom has a funding shortfall of R190 billion for the construction of Kusile power station and Ingula power pumped storage scheme between now and 2017.¹²

Eskom's debt as from 31 March 2010 is R94-billion compared to R50-billion last year, and much of it has been raised to fund the Group's capital expansion programme namely, the construction of Medupi coal-fired power station, Kusile and Ingula power stations.

Below is a breakdown of Eskom's electricity consumers in percentage form:

¹⁰ Eskom (2010) Notes on Financial Statements

¹¹ Ibid.

¹² Khanyile, S. (2010).



• Agriculture	3%
• Commerce	7%
• Industry (energy-intensive users)	36%
• Mining	7%
• Transport	26%
• Residential	18%
• Transport	26%
• Other	3%

The percentage above explains why energy-intensive users are Eskom's major clients, and also the impact they have on the utility's financial performance. The details which seem to have a huge impact on Eskom's finances are however hidden in the confidential contracts signed between the two parties.

9. Human Resource

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 saw the rise among black staff from 75.3% to 78.1% in 2006. Conversely, the number of female promotions 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 profile¹³

Level	Black		Coloured		Indian		White	
	M	F	M	F	M	F	M	F
Top management	5	2	1	1	4	1	6	1
Snr management	76	40	13	12	43	18	164	22
Engineers	1011	586	193	53	349	99	576	112
Technical staff	1467	1052	288	62	95	20	959	89
Artisans	1722	238	238	14	35	0	766	26
Semi-skilled	8689	1582	1003	273	62	76	516	727
Unskilled	2289	1425	198	86	156	83	494	173
TOTAL	15259	4925	1934	501	744	297	3481	1150

Eskom has a total workforce of 39 222¹⁴ and by March this year there were only 5 females in top management positions compared to 16 males in the same positions. Overall, there are about 97 females at Eskom occupying both top and senior positions compared to 312 males in the same positions.¹⁵ In terms of employment equity there are about 216 black employees (Africans, Coloureds and Indians) in top and senior positions compared to about 193 white employees in the same

¹³ Hogan, B. (2010).

¹⁴ Eskom (2010).

¹⁵ Hogan, B. (2010).



positions.¹⁶ However, 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.¹⁷ In February this year there were about 1228 vacancies at Eskom according to the Minister on Public Enterprises, Ms Barbara Hogan.¹⁸

A report released by the Employment Equity Commission confirmed the male domination scenario reflected at Eskom as in other South African businesses. The report revealed that white men hold 62.9 percent of management positions especially in the private sector while representing only 6.7 percent of the economically active population.¹⁹ On the other hand white women hold 10.2 percent compared with 2.6 percent held by African women, 1 percent by coloured women and 1.3 percent by Indian women. To address these discrepancies, government intends to amend the Employment Equity Act to enable it to introduce legal consequences for companies that flout the law.

Eskom's manpower increased by a net 1 365 to 39 222 resulting, together with salary increases, in a 14.9% increase in manpower costs from R15, 1 million to R17, 4 million. It is envisaged that Eskom's manpower needs will continue to grow to bolster core and critical skills in the context of a capacity expansion programme. On skills development, Eskom invested about R758m in 2010 for the development and training of its staff. Areas of focus include leadership, technical and engineering categories as well as artisan.²⁰

10. Media reports on Eskom salary increases

In July Eskom workers threatened to go on strike demanding a 9% increase plus a housing allowance of R2500 per worker. Eskom's remuneration report released early in July revealed that the entity's top six executive directors and executive committee members got 25% more cash in the financial year under review.²¹

- R4-million paid to former Eskom CEO Jacob Maroga for the seven months he spent at Eskom before his exit.
- R5.9 million paid to Brian Dames, former Director of generation, stockpiles and electricity supply.

The remaining four executive members received an average 59% cash increase on their salaries and short term bonuses, totalling R5, 3 million in overall. Mike Schussler an economist by trade slammed Eskom's salary increases saying, "Eskom's Executive Committee is immoral to allow such huge increases for themselves while electricity increases of 25% will be forced upon consumers year after year for the next few years."²²

¹⁶ Ibid.

¹⁷ Eskom (2010) Annual Report.

¹⁸ Hogan, B. (2010).

¹⁹ Enslin-Payne, S (2010).

²⁰ Eskom (2010) Annual Report.

²¹ Ndlangisa, S. et al (2010)



11. Auditors' opinion

Eskom's financial statements according to *KPMG* and *SizweNtsaluba vsp* auditors present fairly, in all material respects, the financial position of the company and of the group as at 31 March 2010, and in the manner required by the Public Finance Management Act (No. 1 of 1999) and the Company's Act (1973).

12. Conclusion.

Eskom's financial performance has improved a lot since making a R9, 1-billion loss in the previous financial year. The re-negotiation of the contracts with energy-intensive users seems to have been the key to Eskom's improved financial status. Despite these achievements Eskom's leadership squabbles earlier this year nearly compromised the utility's reputation especially to credit rating agencies. Eskom should also be commended for managing the energy saving campaign in the manner it has done, as there were no load-shedding in the financial year under review. Eskom's focus from now on will have to be on the infrastructure programme and the funding requirements of the projects currently underway. And sooner or later, the utility will have to show its commitment on energy mix to reduce greenhouse gas emissions as a result of its coal-fired power stations.

13. Possible Questions

Question

1. Nearly 90% of Eskom's energy is produced from coal and the amount of carbon dioxide released in the air through this process is usually more than 200 million tons. Eskom promised in 2008 to reduce the coal component of its generation capacity from 90% to 70%.²² The table above also shows that coal remains Eskom's dominant component with no signs of abating as the Medupi power station is also coal-fired. What measures Eskom has put in place to reduce greenhouse gas emissions?

2. One of the chronic challenges Eskom has been struggling with in the past financial years is cable theft and the committee will perhaps appreciate if Eskom can explain how it has managed this challenge in the financial year under review? Is the practice increasing or decreasing?

Eskom has indicated in the 2010 annual report that it has successfully renegotiated its contract with the aluminium producers. Does this mean that all Eskom's contracts based on Special Pricing Agreements have been renegotiated, taking into account that there were more than

²² Ndlanguisa, S. et al (2010).

²³ South African Press Association (2008).



30 contracts?

3. It has been alleged that Eskom's executive spent about R12-million on World Cup tickets for their families (wives, children and girlfriends). How has this expenditure benefited Eskom from a business point of view?

4. Eskom's employee costs have been increasing consistently from R11, 353 million in 2007/08 to R15 166 million in 2008/09 and to R17, 4 million in the financial year under review. Often times these increases are only of benefit to senior managers - from a labour perspective and also taking into account an aborted strike by Eskom general workers demanding wage increases during the FIFA World Cup, what is Eskom's view on the wage gap?

5. Eskom has piloted a Utility Load Manager (ULM) as a system that can limit load available to a residential premise. If Eskom can explain how the ULM will be rolled-out or whether it will be compulsory or optional to electricity users?

6. Eskom reported last year that the utility's reserve margin was around 8% and less than the 15% internationally accepted as reliable reserve margin. Has the utility's reserve margin improved from the 8% that was reported last year?

7. Coal transportation is a thorny issue for the Department of Transport because of the damage it cause to SA national roads. The committee will perhaps appreciate if Eskom can explain if it is doing anything to reduce the impact coal transportation has on roads – or even shift from road to rail.

14. References.

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