



Critical Electricity Sector Decisions

Presentation to BUSA Economic Sub-Committee

14 October 2019



Overview of critical decisions

Eskom rescue

- Eskom CEO appointment
- Eskom debt relief and refinancing mechanism
- Climate-linked finance facility
- Municipal debt arrears
- Eskom restructuring path

- + strengthening of board and management
- + compressing coal and people costs
- + NERSA tariffs

Security of supply

- IRP
- Next IPP procurement
- Freeing up distributed electricity generation market

Will government's
Eskom paper deal
with these
adequately



Eskom's financial performance continues to deteriorate

	2007	2018	2019	Now
Total installed capacity (MW)	42,618	45,561	44,172	
Electricity sales (GWh)	218,121	212,190	208,319	
Revenue (R millions)	39,389	177,424	179,892	
Average selling price (c/kWh)	18	83.6	86.4	102c/kWh
Coal purchases (Mt)	117.4	115.49	113.8	
Coal costs (R millions)	10,000	50,123	58,500	17% Y/Y
Employee costs (R millions)	9,451	29,454	33,272	13% Y/Y
Employee numbers (group)	32,674	48,628	46,665	
Debt securities and borrowings (R millions)	40,455	388,684	440,610	



Understanding the problem:

Eskom is insolvent; too large to fail; too large to continue bailing out

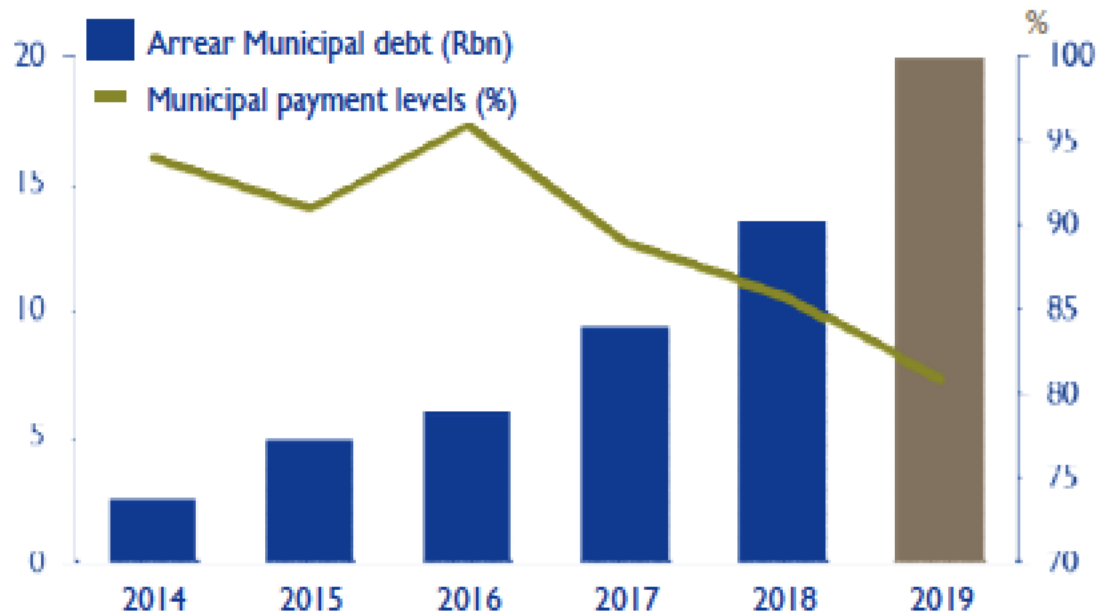
- Pre-tax **loss R29bn** for FY19
 - Largest SOE loss on record
- Debt service cover ratio FY19: <0.5
 - Eskom generates less than half of the cash it needs to service interest and principal R 44 -> 69 -> 84 bn between 2017-19
 - **Debt trap: borrowing to repay its debt**
 - Gross debt to EBITDA ratio >15; should be closer to 5
- State bailouts completely unsustainable; 2019/20 to 20/21
R 23bn + R 26bn + R 23bn + R 33bn

Ratio	March 2019	March 2018	
EBITDA margin, %	18	26	↓
Cash interest cover, ratio	0.9	1.2	↓
Debt service cover, ratio	0.5	0.9	↓
Gross debt/EBITDA, ratio	15.6	9.7	↑
Debt/equity (including long-term provisions), ratio	3.1	2.5	↑
Gearing, %	76	72	↑
Free funds from operations after interest as % of gross debt, %	(1)	2	↓

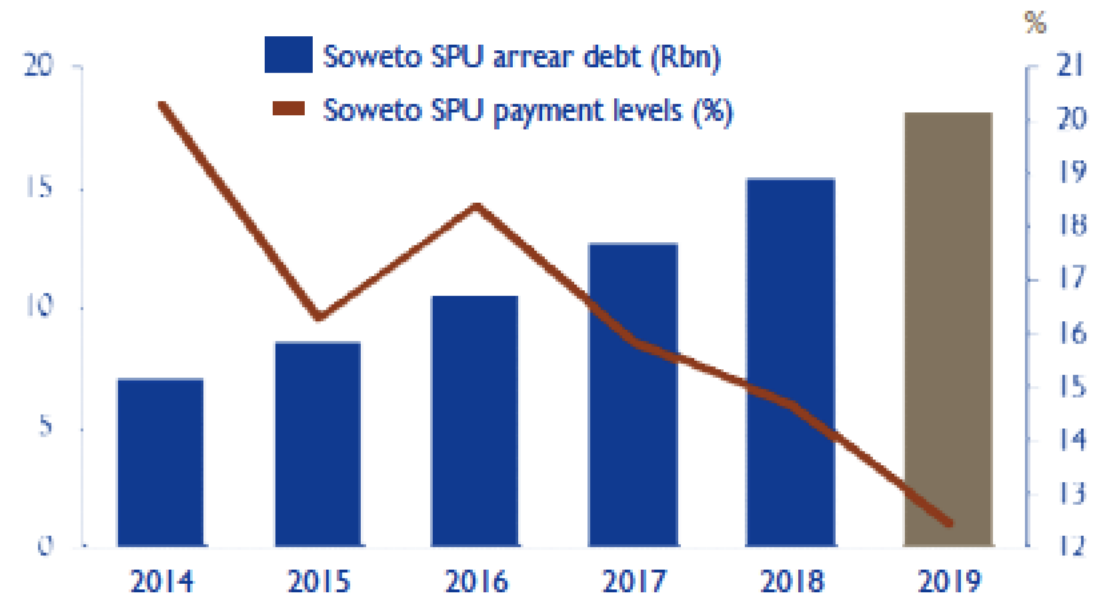


Municipal debt arrears are out of control

Invoiced municipal arrear debt, R billion



Soweto small power user (SPU) debt, R billion





Eskom – in its own words

Eskom in its current form is unsustainable



Debt

Debt approaching R450B

Unable to service from own EBITDA

Must borrow to service debt



Revenue

Volume declining 1% per year, not coming back

Tariffs not cost reflective

R38Bn in receivables outstanding



Costs

Opex increased 30% in 5 years, reaching R151B in FY19

Large increases in employee, coal costs and IPP payments



Operations

EAF below 70% during FY19

Load shedding, increased costs, lost revenue, lost credibility



Outdated Business Model

Utility death spiral

Operational and structural inefficiencies

Lack of transparency

Change in energy landscape

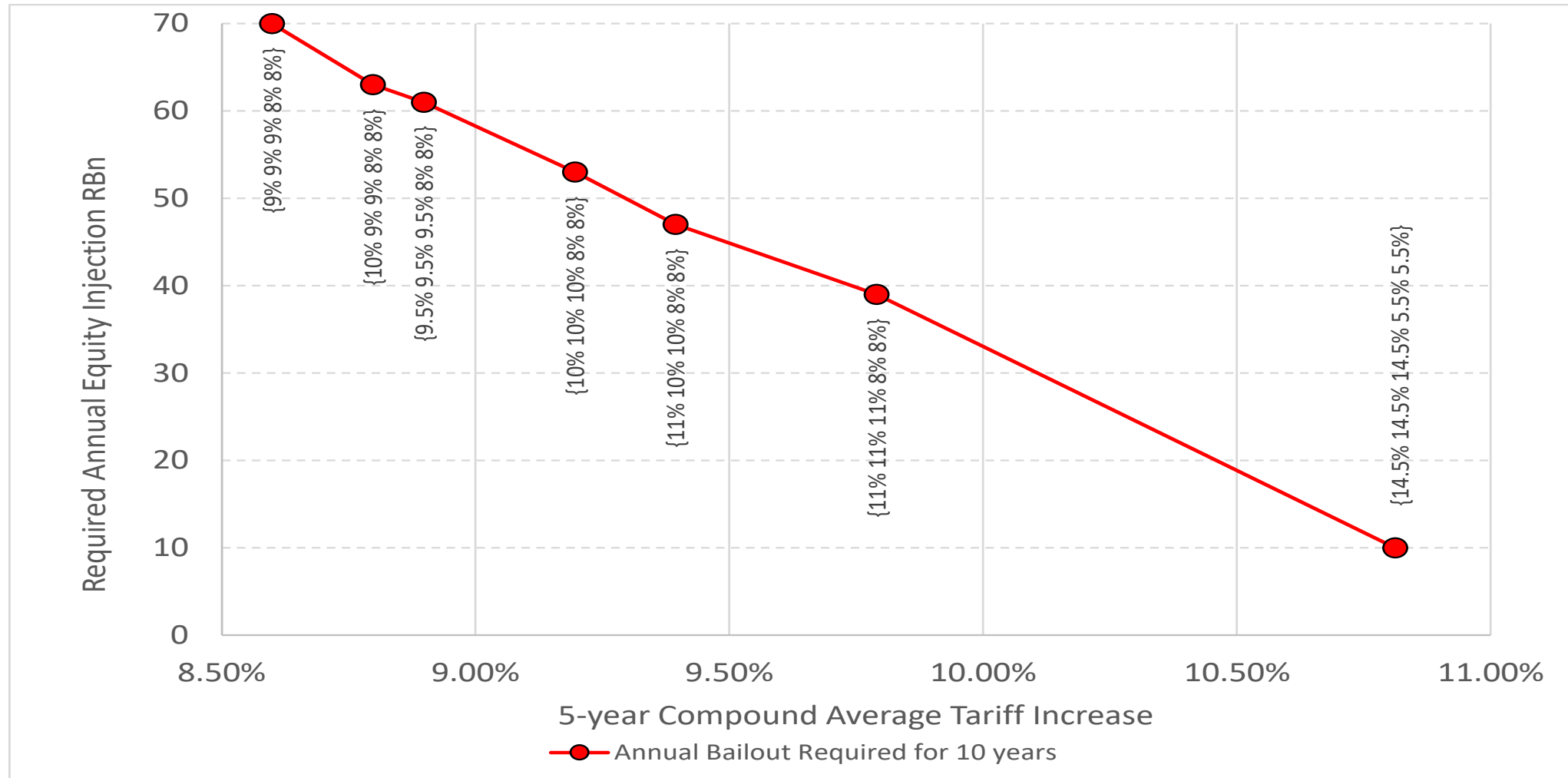
CEO decision is absolutely critical



- Three candidates short-listed
- One stands head and shoulders above the rest in terms of Eskom AND big corporate leadership experience. Performed best in interviews
- But will government make a politically-correct appointment instead?
- This will be the 10th CEO appointment in 10 years!
- Eskom cannot be turned around unless there is strong, competent leadership
- The business community needs to send a clear message to government on this



Tariff support PLUS debt relief/refinancing needed





Proposals for debt relief and refinancing

1. Status quo (on-going equity injections)
2. Direct fiscal debt take-over (a portion or all of it)
3. Fiscal debt take-over into dedicated refinancing mechanism (SPV)

X

- Not a long-term solution; unaffordable (requires at least ~R50 bn pa)
- Risk of further credit ratings downgrades
- Risk of broader political instability as resources diverted from other important causes
- Creates moral hazard for Eskom and other SOEs
- Reduces pressure to complete the unbundling



Eskom debt relief and refinancing choices

X

- Increases South Africa's debt-to-GDP ratio by ~ 6 % points
- Increases cost of refinancing Government debt. Hides full cost of bailing out Eskom.
- Pari pasu principle holds
 - Likely to result in a selective default (“A distressed exchange offer.” – S&P)
- Creates moral hazard for Eskom & other SOEs
- Reduces pressure of unbundling and turnaround of underlying business operations



- State owned, Treasury controlled, special purpose vehicle offers to buy existing Eskom debt on same conditions.
- Refinances Eskom's debt at near-government rates
- Annual state support will flow to this entity.
- Enables the restructuring of Eskom Holdings and turnaround to proceed without delay.
 - Restructuring separates the performing from the under-performing parts of the business
 - Designed to impose financial discipline & leverage value.
 - Allows parts of the bu ✓ (now unencumbered by the underperforming areas) to return to the markets.



President Ramaphosa on Eskom

“Eskom is in crisis and the risks it poses to South Africa are great. It could severely damage our economic and social development ambitions. We need to take bold and decisive action.....To position South Africa’s power sector for the future, we shall immediately embark on a process for establishing three separate entities – Generation, Transmission, Distribution, under Eskom Holdings.....Of particular and immediate importance is the entity to manage an independent state-owned transmission grid combined with the system operator, and power planning, procurement and buying functions. It is imperative that we undertake these measures without delay...”

Why we need to restructure Eskom



- Generation, transmission and distribution very different businesses: latter is customer facing, former is fixing old kit
- Improved management and operational focus; ring-fences financial contagion
- Improved cost transparency
- Linked to refinancing: transmission will quickly return to investment grade and capital markets; generation business will need to be restructured
- 106 power utilities globally have unbundled
- Current vertically-integrated, monopoly model broken -> in-efficiencies, no transparency, corruption, utility death spiral, too big to fail, too big to bailout
- An independent transmission / system operator establishes a transparent, fair platform for competitive procurement of least-cost power
- Sets the industry on a new path, with more competition and private sector investment
- Eskom generation can develop new business model



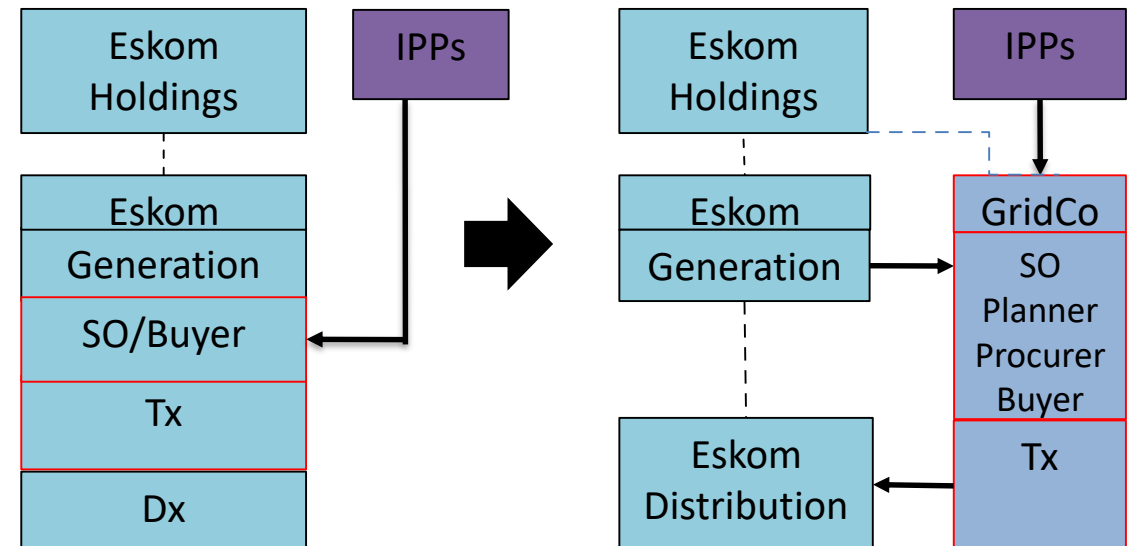
Need to choose between two restructuring routes

1. BCG/Eskom proposal X

- Slow Eskom-led functional unbundling followed by accounting and legal separation after 5 years
- Could easily be reversed
- Not linked to debt rest :uring

2. Task team proposal

- Create shell Transmission / SO subsidiary now with its own board to drive migration of people, systems, assets and debt into new company. Once operational, take out as independent company
- Link immediately to debt restructuring
- Can demonstrate immediate progress



In the meantime, South Africa is short of power and load-shedding could return

System Status Including 2200MW Operating Reserves				Base Case					Base Case + 1000 MW Risk					Base Case + 2000 MW Risk				
Date	Peak Forecast	Planned Outages	Unplanned Assumptions	Expected Shortfall Excl Gas	Likely Load Reduction Required	Stage	Estimated Gas Generation	Estimated Gas Generation Cost (Rm)	Expected Shortfall Excl Gas	Likely Load Reduction Required	Stage	Estimated Gas Generation	Estimated Gas Generation Cost (Rm)	Expected Shortfall Excl Gas	Likely Load Reduction Required	Stage	Estimated Gas Generation	Estimated Gas Generation Cost (Rm)
Fri 01/Nov/2019	28542	6574	8500	-627	0		0	R 0.00	-1627	0		2118	R 7.45	-2627	0		14657	R 51.59
Sat 02/Nov/2019	27404	6574	8500	511	0		0	R 0.00	-489	0		0	R 0.00	-1489	0		489	R 1.72
Sun 03/Nov/2019	27800	6694	8500	-5	0		0	R 0.00	-1005	0		5	R 0.02	-2005	0		1005	R 3.54
Mon 04/Nov/2019	29742	6694	8500	-1947	0		1077	R 3.79	-2947	0		3396	R 11.95	-3947	0		7425	R 26.14
Tue 05/Nov/2019	30021	6694	8500	-2226	0		1716	R 6.04	-3226	0		4617	R 16.25	-4226	0		9587	R 33.75
Wed 06/Nov/2019	29800	6586	8500	-1897	0		1059	R 3.73	-2897	0		3754	R 13.21	-3897	0		8656	R 30.47
Thu 07/Nov/2019	29702	6586	8500	-1799	0		799	R 2.81	-2799	0		3567	R 12.56	-3799	0		8862	R 31.19
Fri 08/Nov/2019	28673	7161	8500	-1345	0		345	R 1.21	-2345	0		2479	R 8.73	-3345	0		13930	R 49.03
Sat 09/Nov/2019	27383	6546	8500	560	0		0	R 0.00	-440	0		0	R 0.00	-1440	0		440	R 1.55
Sun 10/Nov/2019	27743	6546	8500	200	0		0	R 0.00	-800	0		0	R 0.00	-1800	0		800	R 2.82
Mon 11/Nov/2019	29813	6546	8500	-1870	0		939	R 3.31	-2870	0		4319	R 15.20	-3870	0		11055	R 38.91
Tue 12/Nov/2019	30069	7266	8500	-2846	0		3858	R 13.58	-3846	0		9209	R 32.42	-4846	432	①	21302	R 74.98
Wed 13/Nov/2019	29662	7266	8500	-2439	0		2990	R 10.53	-3439	0		8514	R 29.97	-4439	26	①	20531	R 72.27
Thu 14/Nov/2019	29824	7266	8500	-2601	0		3518	R 12.38	-3601	0		9602	R 33.80	-4601	188	①	23210	R 81.70
Fri 15/Nov/2019	28522	7288	8500	-1321	0		321	R 1.13	-2321	0		3259	R 11.47	-3321	0		17029	R 59.94
Sat 16/Nov/2019	27303	7168	8500	18	0		0	R 0.00	-982	0		0	R 0.00	-1982	0		1687	R 5.94
Sun 17/Nov/2019	27369	7168	8500	-48	0		0	R 0.00	-1048	0		48	R 0.17	-2048	0		1048	R 3.69
Mon 18/Nov/2019	29558	7168	8500	-2237	0		1924	R 6.77	-3237	0		6238	R 21.96	-4237	0		15791	R 55.58
Tue 19/Nov/2019	29511	7168	8500	-2190	0		1717	R 6.04	-3190	0		6145	R 21.63	-4190	0		15852	R 55.80
Wed 20/Nov/2019	29516	7168	8500	-2195	0		1894	R 6.67	-3195	0		6291	R 22.14	-4195	0		17111	R 60.23
Thu 21/Nov/2019	29662	7168	8500	-2341	0		1916	R 6.74	-3341	0		6274	R 22.09	-4341	0		14807	R 52.12
Fri 22/Nov/2019	28276	7761	8500	-1548	0		548	R 1.93	-2548	0		3426	R 12.06	-3548	0		15205	R 53.52
Sat 23/Nov/2019	27128	7761	8500	-400	0		0	R 0.00	-1400	0		400	R 1.41	-2400	0		3217	R 11.32
Sun 24/Nov/2019	27205	7761	8500	-477	0		0	R 0.00	-1477	0		477	R 1.68	-2477	0		2215	R 7.80
Mon 25/Nov/2019	29531	7761	8500	-2803	0		3782	R 13.31	-3803	0		9413	R 33.14	-4803	390	①	22449	R 79.02
Tue 26/Nov/2019	29469	7761	8500	-2741	0		3552	R 12.50	-3741	0		10555	R 37.15	-4741	328	①	25132	R 88.46
Wed 27/Nov/2019	29258	7946	8500	-2715	0		4986	R 17.55	-3715	0		14452	R 50.87	-4715	301	①	29445	R 103.65
Thu 28/Nov/2019	29012	7946	8500	-2469	0		3666	R 12.90	-3469	0		13149	R 46.29	-4469	55	①	27970	R 98.45
Fri 29/Nov/2019	27929	7946	8500	-1386	0		386	R 1.36	-2386	0		7552	R 26.58	-3386	0		22434	R 78.97
Sat 30/Nov/2019	26973	7946	8500	-430	0		0	R 0.00	-1430	0		430	R 1.51	-2430	0		3870	R 13.62
Monthly Gas Totals:					0		40,993	R 144.29		0		139,692	R 491.72		1,720	①	377,208	R 1,327.77

Eskom Daily System Status Projection for October 2019

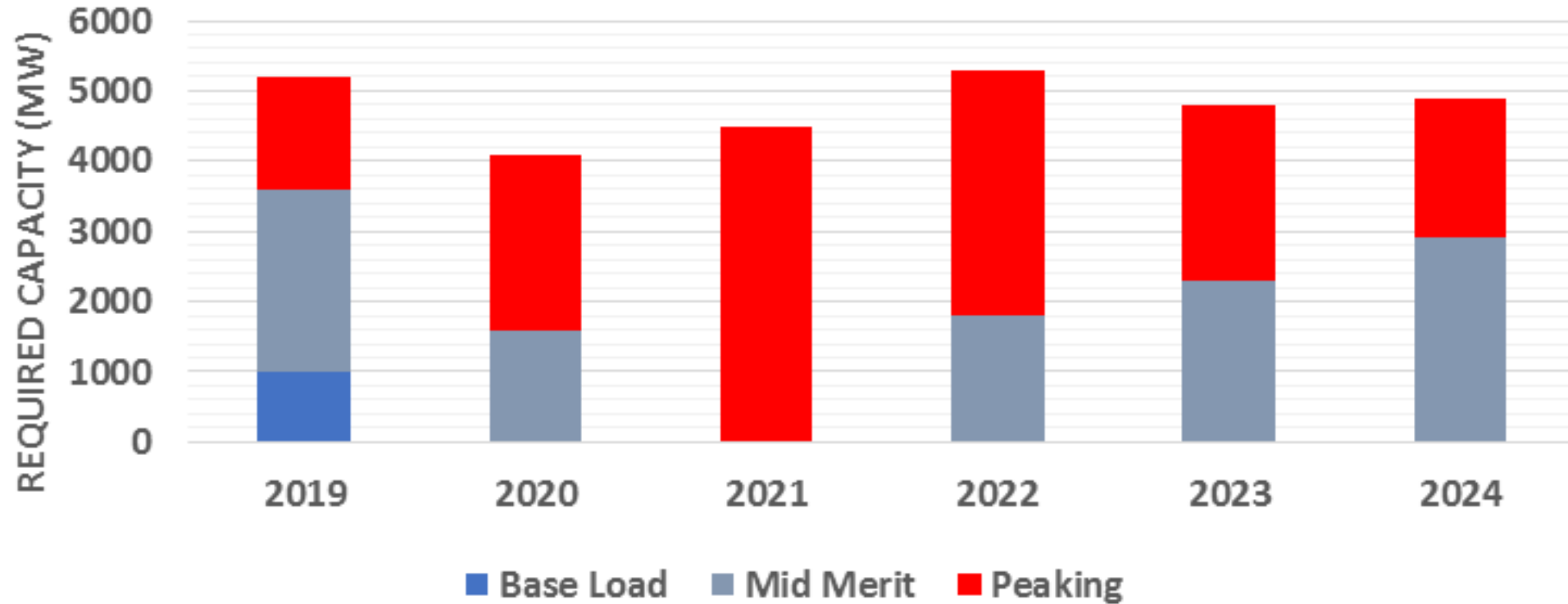
- Significant variations can occur due to changes in planned maintenance, unplanned outages and variations in the demand.
- The estimated gas generation is an energy calculation over all the hours of each day and is expressed in MWh.
- The load reduction is an approximation of the highest magnitude (MW) and stage of reduction required for each day.

Source: Eskom

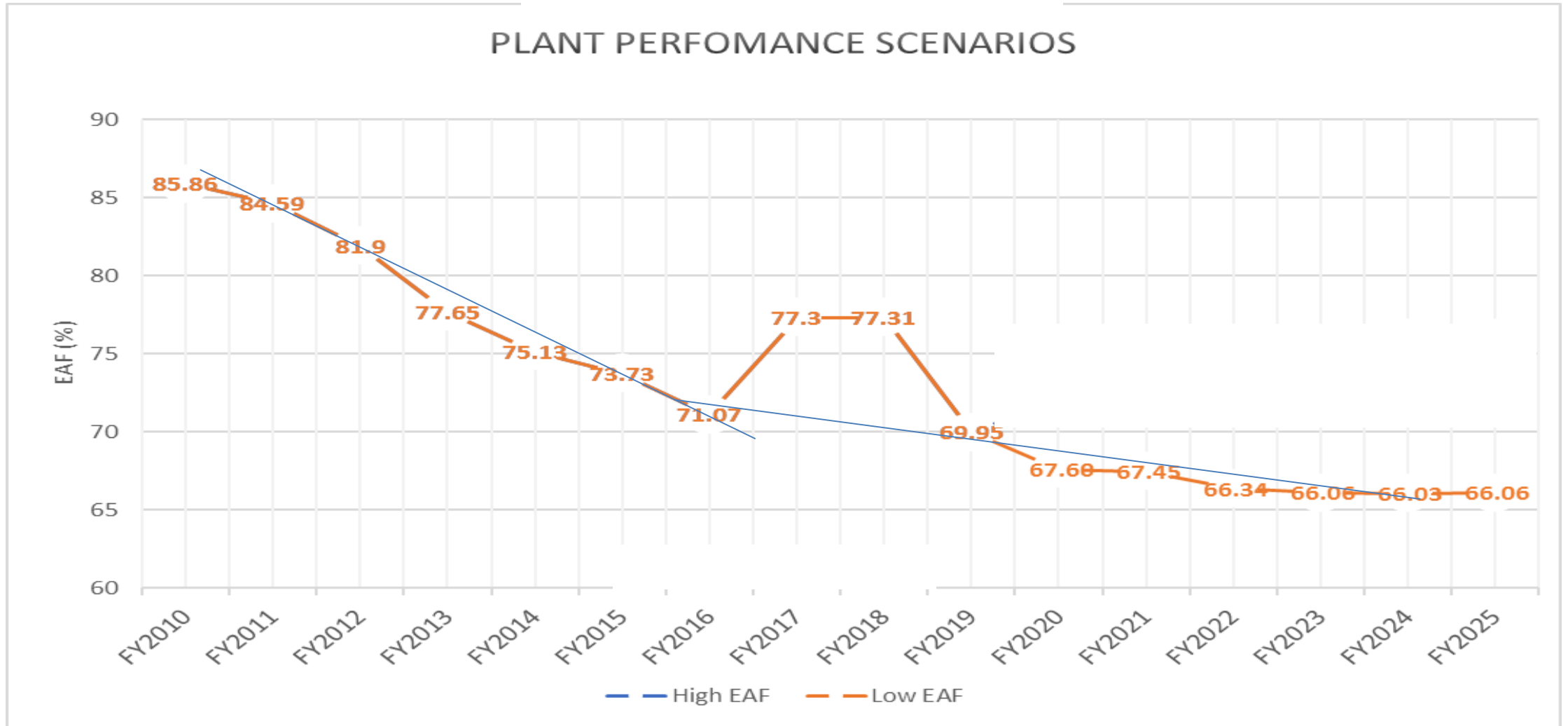


Eskom Medium Term System Adequacy Outlook

A shortage of 4000 and 5000 MW



Improvements in Eskom Generation Energy Availability Factors would make a huge difference but now VERY difficult with ageing plant





South Africa needs to procure new power asap

- As Eskom struggles to keep the lights on and the performance of its power stations remains unsatisfactory, new power investments are urgently needed (MTSAO)
- Eskom doesn't have the balance sheet to fund new power
- Coal, nuclear, gas cannot be built in 3 years; solar + wind can
- **REIPPP round 5** needed asap. Prices will come in below ZAR 45c/kWh and dispel perceptions that IPPs are expensive; supported by complementary flexible resources
- **Direct contracting** between IPPs and large consumers needs to be facilitated
- Regulatory reform - e.g. exempting small **scale distributed generation** projects <10MW from the requirements of a licence – will liberate a

Urgent messages for President



- Appoint a **CEO with proven leadership** capability
- Now is the time to move boldly on **restructuring Eskom** so that we are not faced with endless bailouts and so that competition and investment are accelerated
 - BCG/Eskom proposal for slow functional unbundling won't cut it
 - Rather establish Transmission Subsidiary and appoint its Board to DRIVE the unbundling. This can be done with sensitivity to labour issues
- Be decisive on **debt relief and refinancing mechanism**. If the simpler option of debt transfer to the sovereign is chosen, understand that this will be more costly and less effective in Eskom restructuring than SPV option
- Mandate Eskom Task Team to explore feasibility of **lower-cost climate-linked finance** for Eskom

END