FINANCIAL AND FISCAL COMMISSION

Briefing by the Financial and Fiscal Commission on the 2019 Special Appropriation bill

18 September 2019

PRESENTATION OUTLINE

1. Introduction
2. Overview of Eskom Financial Position
3. Details and Implications of Government's Support Strategy
4. Commission’s Proposed Measures to Improve Eskom Sustainability
5. Conclusion

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1. Introduction and Context within which the Special Appropriation Bill is Tabled

Introduction and Context within which the Special Appropriation Bill is Tabled (1)

- Submission made in terms of S4(4c) of MBPARMA (Act 9 of 2009)
  - Requires Parliamentary Committees to consider any recommendations of FFC during deliberations on Money Bills
- Also made in terms of FFC Act of 1997 as amended
  - Requires that FFC responds to any requests for recommendations by any organ of state on any financial and/or fiscal matter(s) relevant to its mandate
- What is the FFC?
  - Permanent statutory body established in terms of Section 220 of Constitution
  - Independent and subject only to Constitution and the law
  - Must function in terms of an act of Parliament
    - Financial and Fiscal Commission (FFC) Act1997 as amended.
- The Commission makes recommendations to Parliament on the equitable division of nationally raised revenue and on any other financial and fiscal matters

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Comparison between government guarantee and exposure for the 2018/19 fiscal year, top-10 Beneficiaries

R million	2018/19			
	2018 Budget Review: Guarantee	2019 Budget Review: Exposure	Share	Deviation: Over/(Under)
Eskom	235 842	294 713	33.5%	58 871
Road Accident Fund	224 674	216 063	24.6%	(8 611)
Independent power producers	116 892	146 892	16.7%	30 000
Post-retirement medical assistance	69 938	69 938	8.0%	-
South African National Roads Agency Limited	28 382	30 289	3.4%	1 907
Claims against government departments	34 957	28 749	3.3%	(6 208)
Export Credit Insurance Corporation of SA Limited	19 099	23 167	2.6%	4 068
South African Airways	11 770	17 311	2.0%	5 541
Trans-Caledon Tunnel Authority	18 779	14 857	1.7%	(3 922)
Public-private partnerships	8 705	10 090	1.1%	1 385
Other	26 521	27 579	3.1%	1 058
Total contingent liabilities	**795 559**	**879 648**	100.0%	**84 089**

Source: 2018 & 2019 Budget Reviews, National Treasury, Statistical Table 11 - Net loan debt, provisions and contingent liabilities, National Treasury

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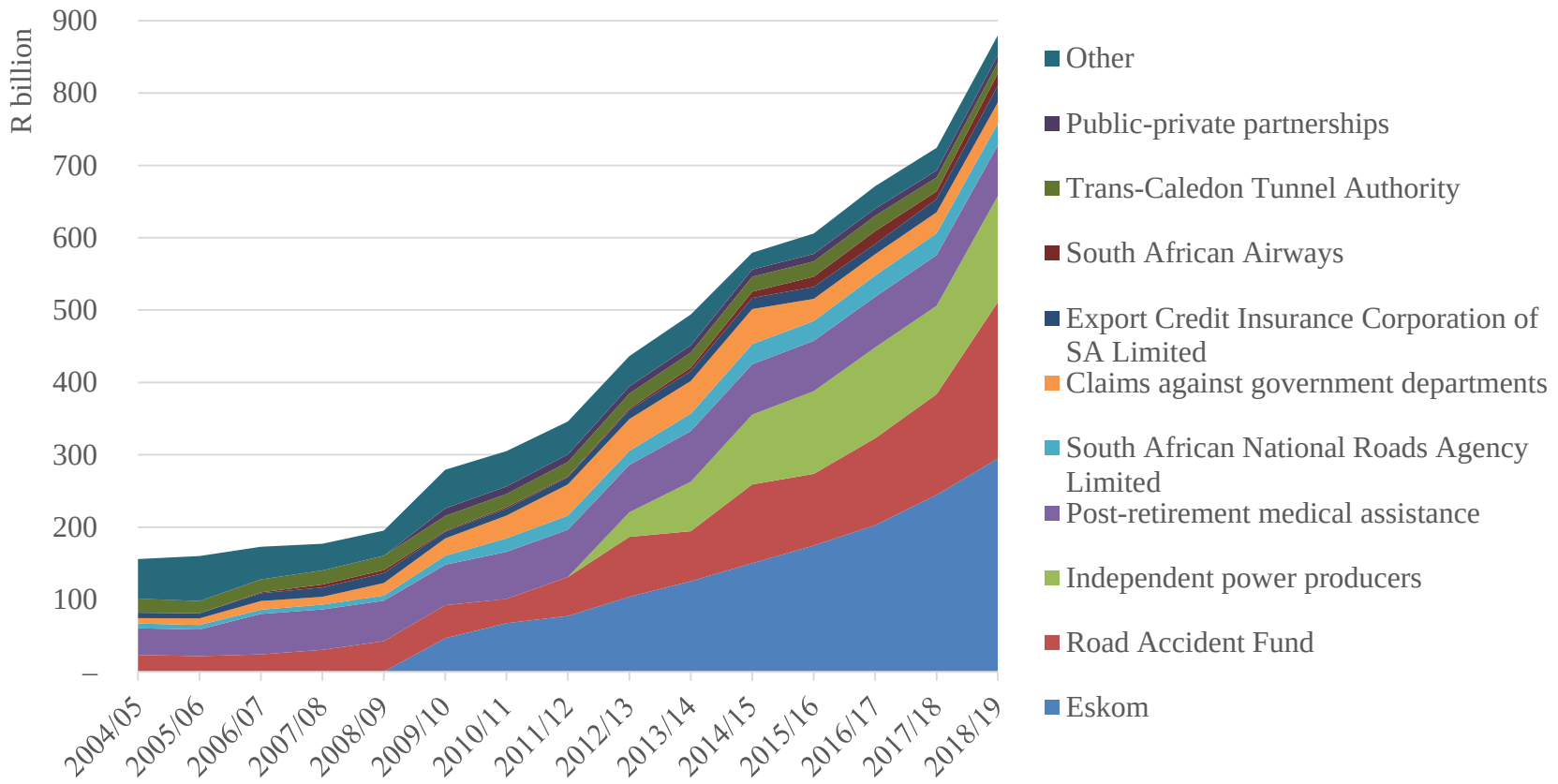
Government Guarantee Exposures, 2018/19 Fiscal Year



Source: 2018 & 2019 Budget Reviews, National Treasury, Statistical Table 11 - Net loan debt, provisions and contingent liabilities, National Treasury

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2. Overview of Eskom Financial Position

Joint Meeting: Standing Committee on Appropriations, Portfolio Committee on Public Enterprises and Select Committee on Appropriations (10 September 2019)

- Eskom **would not** have been able to remain **solvent** in **October 2019**, had it not been for the **special provisions** made in the **two appropriation bills**, on top of the **government guarantees already provisioned.** – Minister of Public Enterprises
- Eskom has been compelled to find coal supplies from **wherever**, at **whatever quality they can**, **even substandard coals that could damage the boilers at expensive contracts.** Eskom has also been **burning diesel fuel** to continue supplying electricity at high costs**, which incurs losses and requires more borrowing for servicing and rolling over debts**.
- Of the **debt on municipal bulk accounts** totaling **R19.889 billion** as at March 2019, **R18.9 billion is considered not recognisable as revenue** by the Auditor General.
- **Tariffs are not cost reflective**, especially for major industrial users such as mining and manufacturing houses, due to preferential tariffs (Eskom vs. NERSA)
- The **Special Paper on Eskom roadmap** to be published by the President within this month.

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2007 vs. 2019 Eskom: Operations

	2007	2019	%change
Total Installed Capacity (MW)	42 618	44 127	3.5%
Electricity Sales (GWh)	218 120	208 319	-4.5%
Revenue (R'bn)	39.4	179.9	356.6%
Average selling price (c/kWh)	18	90.01	400.1%
Coal Purchases (Mt)	117.4	118.3	0.8%
Coal Costs (R'bn)	10	58.5	485.0%
Employee Costs (R'bn)	9.5	33.3	250.5%
Employee Numbers	32 674	46 665	42.8%
Debt Securities and Borrowings (R'bn)	40.5	440.6	987.9%

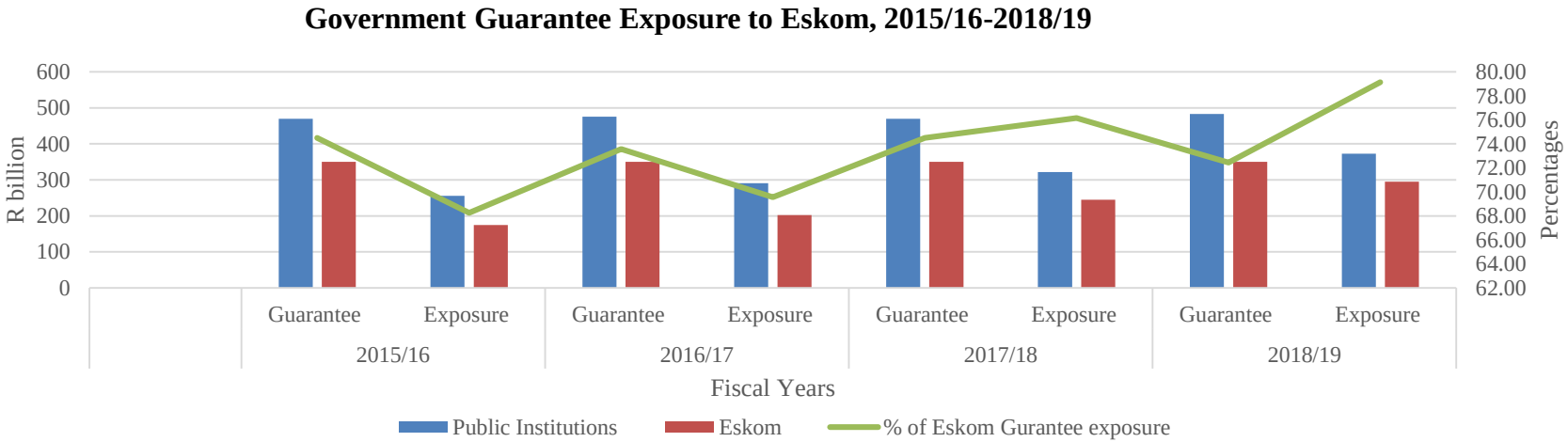
Source: Eskom (2019)

INCOME STATEMENT OF ESKOM

R billion	2007	2019	%change
Revenue generated	40.1	179.9	348.6%
+ Other income	0.5	2.2	340.0%
- Primary energy cost	13.0	99.5	665.4%
- Minus Employee cost	9.5	33.3	250.5%
- Minus other expenses - Maintenance	6.3	18.2	188.9%
= EBITDA	11.8	31.1	163.6%
- Interest payment	1.8	35.9	1894.4%
- Investment requirement	14.1	34.1	141.8%
= Surplus (Shortfall)	(4.1)	(38.9)	848.8%

Source: Eskom (2019)

ESKOM HEAVY RELIANCE ON GOVERNMENT GUARANTEES



Source: National Treasury Budget Review (various)

- Government guarantees to Eskom account, on average, for almost three quarters (74 per cent) of the total government guarantee to all public institutions at R350 billion between 2015/16 and 2018/19. Government guarantee exposure to Eskom has increased by 69 per cent from R174.6.4 billion in 2015/16 to R294.7 billion in 2018/19.
- This significant increase in government guarantee to Eskom constitutes a risk to the sustainability of the fiscus and is credit negative for the government because a high level of contingent liabilities translates into a higher risk premium on, and increased costs of, sovereign debt.

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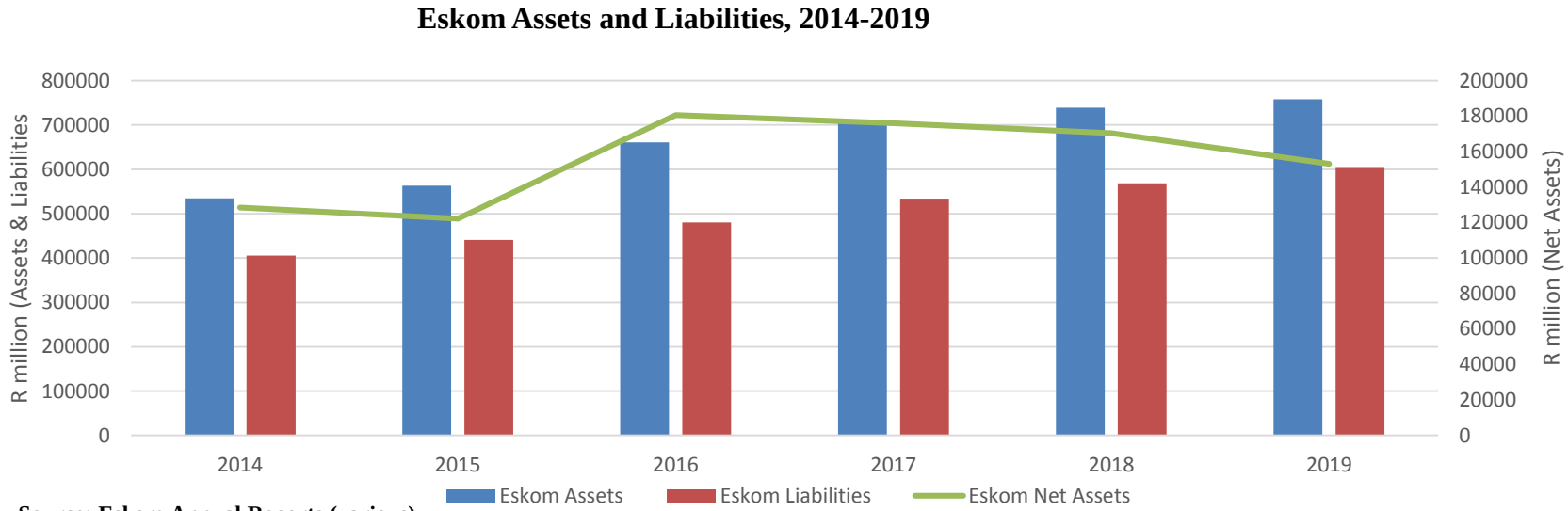
Eskom Net Assets are Declining



Source: Eskom Annual Reports (various)

- The growth in Eskom liabilities is outstripping that of its assets. The liabilities have grown at an average annual of 8.3 per cent between 2014 and 2019 compared to 7.4 per cent for assets over the same period. Net assets recorded negative growth since 2016
- This rapid growth in liabilities compared to assets means that Eskom is compelled to spend a larger portion of its revenue to service its debt costs thus impacting negatively on its cash flow position and liquidity

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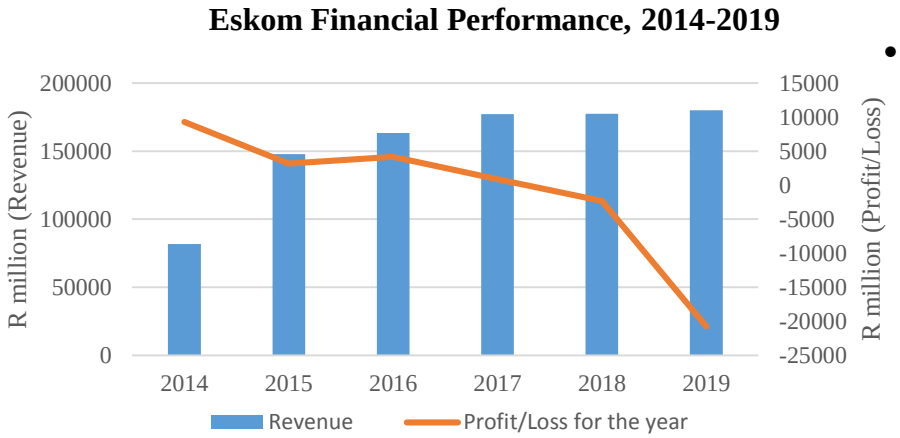
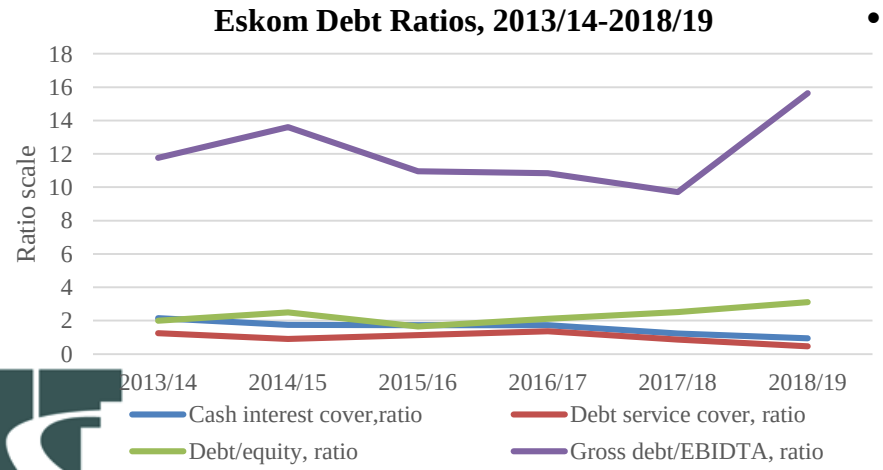
ESKOM FINANCIAL HEALTH IS WEAKENING



- The financial performance of Eskom decelerated from a profit of R9.3 billion in 2014 to a loss of R20.7 billion in 2019. Whereas Eskom revenue grew by 80.3 per cent between 2014 and 2015, it only grew by 1.4 percent between 2018 and 2019. These indicators are a reflection of a poor financial performance by the utility.



Source: Eskom Annual Reports (various)

- Eskom is increasingly financing its operations through debt versus wholly-owned funds as reflected by its debt/equity ratio which increased from 2 in 2013/14 to 3.1 in 2018/19. Its cash interest cover, debit service cover and gross debt/EBIDTA ratios, which are measures of sufficient cash flow to cover debt servicing and ability to pay debt, are all very high (industry norms). They reflect a heavily indebted company.

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3. Details and Implications of Government's Support Strategy

DETAILS OF GOVERNMENT'S SUPPORT STRATEGY

- Eskom is experiencing energy demand stagnation and decline while it has simultaneously embarked on an enormous, coal-fired power station construction programme. This has affected its financial viability.
- The 2019 Budget allocated R23 billion annually to Eskom for the next 10 years to service its debts and meet redemption requirements. Eskom now requires more government support to be financially sustainable and honour its debt obligations.
- Government authorised R17 billion payment to Eskom in April 2019 through Section 16 (1) of the Public Finance Management Act (PFMA) that enables funds in emergency situations.
- The Eskom Special Appropriation Bill consist of additional funding of R26 billion in 2019/20 financial year; and R33 billion in the 2020/21 financial year.

Implications of Support Package on 2019 Appropriation Bill (1)

- The Commission underscores that the energy crisis is perhaps the biggest risk to the 2019 Appropriation Bill. Its throttlehold on the economy was evident in the first quarter of 2019, where the economy recorded a 3.2% negative growth rate partly due to load shedding.
- On the positive side, the bailout sends positive signals to investors that government is committed to resolving the energy crisis. Investors will appreciate the fact that Eskom will not be allowed to collapse. This support will ensure that Eskom is up to date with its debt obligations and be able to access financial markets in future.
- On the negative side: The R59 billion bailout to Eskom will compound South Africa's fiscal risks. South Africa essentially becomes a subject to the institutional deficiencies and development at Eskom

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Implications of Support Package on 2019 Appropriation Bill (2)

- Eskom special appropriation will result in the widening of the budget deficit *(especially considering also that poor economic growth will result in revenue under collection)* to above 5.7% in 2020 (in 2019, 5.6%)
- Eskom bailout will also result in the widening of the country's debt to GDP ratio to above 60%.
- Taken together, the above points imply that the bailout will further put South Africa's investment status at risk of downgrade, causing further liquidity challenges.
- The above worrisome situation will be compounded by the fact that the bailout is not anchored in a sound and implementable plan or strategy to get Eskom out of the doldrums and onto a sustainable growth pathway

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Implications of Support Package on 2019 Appropriation Bill (3)

- Furthermore, the bailout is given in the context of a leadership void at Eskom.
- The Commission is also concerned about the deployment of a lone CRO to change Eskom. Locked-in contracts, pushback and resistance to change from the existing governance and human infrastructure may derail efforts of the CRO.
- The Eskom bailout does crowd out other infrastructure investments. It is unproductive government spending. There is abound to be a trade off. This means that there will be reprioritisation or cuts on other fiscal expenditure items (i.e. social services), which could negatively affect service delivery.
- Need to watch the financial governance space very carefully through parliamentary oversight.

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4. Commission's Proposed Measures to Improve Eskom Sustainability

MEASURES TO IMPROVE ESKOM SUSTAINABILITY (1)

The Commission also proposes the following operational actions for Eskom:

- **Reducing the costs of the current and additional IPP contracts**, costs of transporting coal as well as costs associated with coal specifications in the international markets
- Diversification into **alternative energy generation-**(not only coal)
- Acceleration of the deferred infrastructure maintenance programmes
- Acceleration of the outsourcing of **non-core** services
- Speed up the recruitment of a **permanent CEO** and policy clarity with regards to the **Chief Restructuring officer**
- **Clarity and more predictability on future government financial support from Eskom to enhance future financial planning**
- Vigorously pursue the rightsizing of staff complement through **productivity management**.

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MEASURES TO IMPROVE ESKOM SUSTAINABILITY(2)

The Commission proposes the attachment of the following conditions to the 2019 Eskom Special Appropriation Bill:

- A **performance management framework** by Parliament linking the turnaround plan deliverables to **Eskom executive and non-executive pay** and **performance contracts**.
- Clear **key performance areas** with specific **time frames** by National Treasury for the Eskom CRO
- An **oversight framework** of Eskom by an adhoc- committee of parliament entailing quarterly reports outlining the milestones reached in relation to the prescribed set of **performance indicators**
- A comprehensive **legislative and regulatory frameworks** by the Department of Energy with timelines and responsibilities for **energy transition** towards alternative energies.
- A **detailed legislative and regulatory framework** with **timelines and responsibilities for unbundling Eskom into three separate units: generation, transmission and distribution**

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General Measures to Improve Eskom Sustainability: Improvising Efficiencies (3)

High levels of **inefficiency** at Eskom level (due to **monopoly** situation of Eskom; and **leakages, debt** and **billing problems**

- As a virtual monopoly in power generation, all inefficiencies associated with an **absence of competition** are evident in Eskom, e.g. high costs of inputs, delayed repairs and maintenance, etc.
- Government **subsidies/guarantees have prevented the test of competition for operational efficiency** and therefore, incentives for the development of cheap renewable energy technologies and investments.
- In the **distribution** of electricity (in the intergovernmental system), there are also inefficiencies, such as **leakages (unaccounted for electricity), illegal connections to the grid** and **poor billing systems by municipalities**.
- The depth of inefficiencies have huge implications on revenues an inefficient energy sector to the wider economy are critical issues that require further scrutiny.

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General Measures to Improve Eskom Sustainability: Tariff Disparities and Resolving Municipal Debt (4)

- Tariff Disparities: Eskom has different tariffs for different consumers, a phenomenon that has the potential to lower revenues for Eskom.
- Although industry and mining sectors together consume 60% of electricity produced in the country, and residential consumers consume 16% to 18%, the mining and industrial consumers are charged lower prices compared to residential consumers.
- Need to ensure that the incidence of Eskom tariffs is fair and does not compromise revenue yields via cost reflective tariffs.
- Debt owed by municipalities to Eskom is also a factor in the viability of Eskom and it is likely to cripple its operations and long term plans, if it remains unresolved for long. IGFR mechanisms should be catalysed to resolve the debt issue.

5. Conclusion

- The Economy is heavily depended on Eskom. A collapse of Eskom weighs down every sector of the economy.
- The Commission welcomes the unbundling of Eskom.
- The R59 billion Special Appropriation Bill to Eskom (at R26 billion for the 2019/20 Financial Year and R33 billion for the 2020/21 Financial year) is to alleviate a liquidity crunch, rescuing Eskom from insolvency.
- Hence, the Commission remains concerned with financial, operational and technical deficiencies plaguing Eskom, and eager still to learn of a clear plan/strategy to improve the viability of Eskom and return it to profitability.
- The Commission underscores the importance of sound and implementable plans with accountable targets to turnaround Eskom with timeframes. (e.g. review and amend the R440 billion debt contracts)
- The Commission recommend the Special Adjustment Bill for Eskom, but underscores that certain conditions must be included before enactment.

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THANK YOU.

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Submission on 2019 Special Appropriation Bill