Eskom showed a significant turnaround in its performance in the six months to September

By: Matshela Koko, Eskom's Group Executive for Generation

As Eskom's Group Chief Executive Brian Molefe presented the company's interim results last Thursday, I was reminded of the Moody's credit opinion of 20 September 2016. The credit ratings agency stated that "the group's [Eskom's] financial ratios remain very weak as a result of rising operating costs primarily driven by higher primary energy costs and ongoing growth in power purchase agreements with independent power producers (IPPs), as well as the continued roll out of its large capex programme". Moody's expected the financial ratios to remain weak given the persistence of high operating costs and a large planned capital expenditure programme.

In our interim financial results presented last week, Eskom showed a significant turnaround in its performance in the six months to 30 September 2016. Overall, the company's key financial ratios have improved in the period under review compared to the corresponding period last year.

Revenue increased by 10.5% to R97.1 billion, whilst EBITDA (earnings before interest, tax, depreciation and amortization) surged 23% to R31.5 billion on the back of a 31.6% increase in export sales. Overall, electricity sales increased 1.2%.

The group's liquidity position has improved significantly, with liquid assets increasing by 81.6% from R24.1 billion a year ago, to R43.8 billion. The group has access to adequate resources and facilities to continue as a going concern for the foreseeable future.

Furthermore, our cost containment strategy is now bearing fruit. For the period under review, primary energy costs decreased by 1.5% to R40.4 billion compared to an average increase of 18.8% over the last five financial years, reversing a significantly negative trend.

As a result of the increased plant availability and the additional generating capacity that has been added to the grid, our reliance on open-cycle gas turbines has been reduced considerably. Diesel usage decreased from R6.7 billion in the six months to September 2015 to R288 million in the current period.

More primary energy savings could have been realised had the excess energy available from the cheaper coal plants not been displaced by the self-dispatching renewable IPPs at an incremental cost increase of R2.2 billion.

From April to September 2016, renewable energy purchased by Eskom accounted for only 3% of the 122 Terawatt hour (TWh) sent out but contributed a staggering 22% towards the total primary energy costs. Eskom's average price of 83 c/kWh included the cost of 3.6 TWh procured from renewable energy IPPs. The unblended tariff is actually 77 c/kWh, and this is what the consumer should be paying for their electricity. The actual premium that an average consumer paid, attributed to the cost of renewable energy IPPs is 8.2 % or 6 c/kWh. It is this 6 c/kWh that should have been paid for separately by the fiscus in order to fund the renewable energy programme.

Generation plant availability improved from 71.2% to 78.5%, adding an extra 3 700 MW to the national grid from the existing power plants. In addition, a total of 1 793MW of new capacity was brought into commercial operation from Ingula's Units 1, 2 and 4, and Medupi's Unit 5. This enabled the organisation to avoid loadshedding for the past 15 months.

During the period under review, Eskom also electrified 99 869 new households, increasing electrification connections by more than double compared to the same period last year.
Eskom has addressed all the concerns from the Moody's opinion, except for the ongoing growth in the power purchase agreements with the IPPs. If the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) is implemented as is, it will continue to negatively impact the Eskom financial ratios as per Moody's credit opinion of 20 September 2016.

In the 2020/21 financial year, Eskom would require a 7.6% average price increase to fund the purchase of power from IPPs through the REIPPPP. Assuming an inflationary price increase of 6% for Eskom, the resultant effect will be an average price increase of 13.6%. The price increase of 13.6% equates to a projected revenue increase of R37 billion, of which R19 billion would be paid to renewable energy IPPs. Clearly, the IPP costs have a crowding effect on the Eskom tariff because any tariff increase beyond 13% is already unaffordable.

This crowding-out effect would leave Eskom unable to execute its capital programme which averages around R60 billion per annum, half of which is allocated to sustaining current operating assets. The other half is allocated to the capital expansion programmes, including power delivery projects.

Eskom is alleged to be ignoring the costs of Bid Window 4, which are supposed to be cheaper than previous Bid Windows. In Bid Window 4 and 4.5, biomass is priced at 145c/kWh, small hydro is priced at 112c/kWh and concentrated solar power at 500c/kwh during peak hours. There are 19 solar photovoltaic projects priced between 77c/kWh and 116c/kWh and five wind projects that are priced between 70 c/kWh and 75 c/kWh. These are indeed cheaper than previous Bid Windows, but will continue to have a crowding effect on the Eskom tariff. It is therefore correct that these are not prudent costs particularly at the rate at which they are being incurred. This is even more serious given that the current tariff increase of 9.4%, which includes renewable energy costs, is being challenged in court.

Let me take this opportunity to appreciate the leadership of Mr Molefe; our Group Chief Financial Officer Mr Anoj Singh; the Eskom Board of Directors and most importantly the Minister of Public Enterprises, Ms Lynne Brown, for their outstanding service delivery.

Mr Molefe was appointed as the Group Chief Executive in April 2015 and was tasked with turning Eskom around. When he joined Eskom, South Africa was in the middle of a loadshedding crisis. This crisis was not due to lack of electricity generating capacity, but was due to poor generation plant performance. Eskom was spending close to R1 billion per month on diesel and the new build programme was stagnant. The non-delivery of the new build programme and poor plant availability had led to Eskom's liquidity crisis.

When I met Mr Molefe for the first time, he tasked me to perform maintenance without load shedding, and without burning diesel. He came up with the Tetris Planning Tool and defined the concept of maintenance budget. Industry analysts thought he was naïve, unreasonable and unconsciously incompetent. They predicted load shedding would last for 3 to 5 years. They were proven wrong. Today is better than yesterday and tomorrow will be better than today. I am fully behind him.