

# **NERSA Public Hearing**

# **Concluding Remarks MYPD 3**

**Gauteng  
January 2013**



This presentation does not constitute or form part of and should not be construed as, an offer to sell, or the solicitation or invitation of any offer to buy or subscribe for or underwrite or otherwise acquire, securities of Eskom Holdings SOC Limited (“Eskom”), any holding company or any of its subsidiaries in any jurisdiction or any other person, nor an inducement to enter into any investment activity. No part of this presentation, nor the fact of its distribution, should form the basis of, or be relied on in connection with, any contract or commitment or investment decision whatsoever. This presentation does not constitute a recommendation regarding any securities of Eskom or any other person.

Certain statements in this presentation regarding Eskom’s business operations may constitute “forward looking statements.” All statements other than statements of historical fact included in this presentation, including, without limitation, those regarding the financial position, business strategy, management plans and objectives for future operations of Eskom are forward looking statements.

Forward-looking statements are not intended to be a guarantee of future results, but instead constitute Eskom’s current expectations based on reasonable assumptions. Forecasted financial information is based on certain material assumptions. These assumptions include, but are not limited to continued normal levels of operating performance and electricity demand in the Distribution and Transmission divisions and operational performance in the Generation and Primary Energy divisions consistent with historical levels, and incremental capacity additions through our Group Capital division at investment levels and rates of return consistent with prior experience, as well as achievements of planned productivity improvements throughout our business activities.

Actual results could differ materially from those projected in our forward-looking statements due to risks, uncertainties and other factors. Eskom neither intends to nor assumes any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

In preparation of this document we used certain publicly available data. While the sources we used are generally regarded as reliable we did not verify their content. Eskom does not accept any responsibility for using any such information.

- We would like to thank stakeholders for the constructive inputs
- We want the same things –there is agreement on a number of issues:
  - Ensuring a stable and secure supply to empower the economy is essential
  - The need for job creation and economic growth
  - Protecting the poor and alleviating poverty
  - Protecting the environment
  - The need for Eskom to be efficient
  - Price of electricity needs to increase (range: inflation to 13%)
- What is the right balance?

# Basis of MYPD3 application within current policies, regulatory and financial support frameworks

The regulatory formula allows for the recovery of prudent costs (primary energy and operating), depreciation and a return on assets

1. Costs kept at single digit increases.
  - Primary energy increases of 8,6% (including coal at 10%), operating costs increases of 8% (maintenance key driver)
2. Electricity Pricing Policy (DoE December 2008) – recovery of costs and earning return on assets at replacement value
3. NERSA allowed targeted return of 8.16%.
  - Application reaches 7,8% by 2017/18, averages 4% over the period
  - Return covers interest
4. Debt guarantees – government support of R350bn
  - R60 billion subordinated loan drawn down
5. Maintain debt levels within the R350 billion guarantee ceiling – almost 80% of funding already secured, application includes additional debt within this constraint

- Why can Eskom not apply for inflation increases of 6%?
  - Primary energy costs increases by 8,6% on average (including coal increases to the Mining industry of 10% on average).
    - With Coal at 10% per annum, we cannot apply for inflation linked increase.
  - Operating costs increase by 8% on average
    - Manpower at inflation plus 1% for volume due to business expansion
    - Maintenance costs higher than inflation due to increased maintenance of ageing South African power system
  - Our ability to raise debt is constrained within the support guarantee and loan support we have from Government
  - The electricity system is constrained resulting in higher costs
  - Main drivers for the double digit increase are the depreciation and return on assets components of the application, in the context of historical under-recovery
  - We included an additional 3% to introduce new independent power producers, mainly under the Department of Energy's renewable energy procurement programme

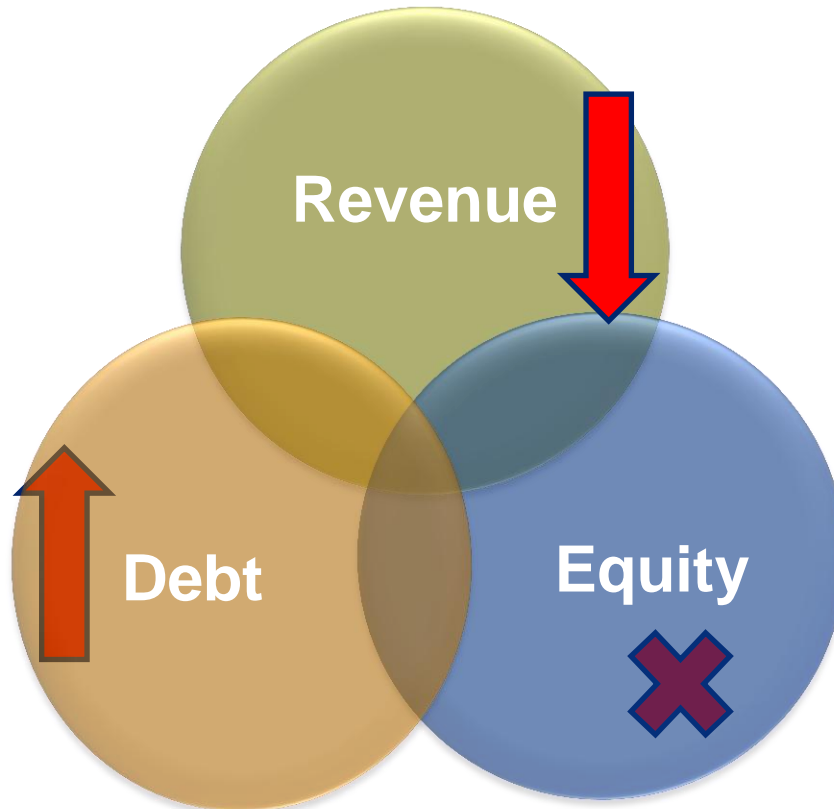
1. Financing of Eskom
2. Eskom Efficiency
3. Policy clarity and integration



# Financing of Eskom

- Context of application:
  - Electricity Pricing Policy
  - Legislation and Regulatory methodology
  - Debt capacity
  - Government support in terms of R350bn guarantees and R60bn subordinated loan fully drawn down
  - Debt raised within R350bn limit
  - Debt secured – 80%
- Eskom has pushed the price path out to 2017/18 to achieve a better price path
- Lower revenue leads to increased debt and higher risk



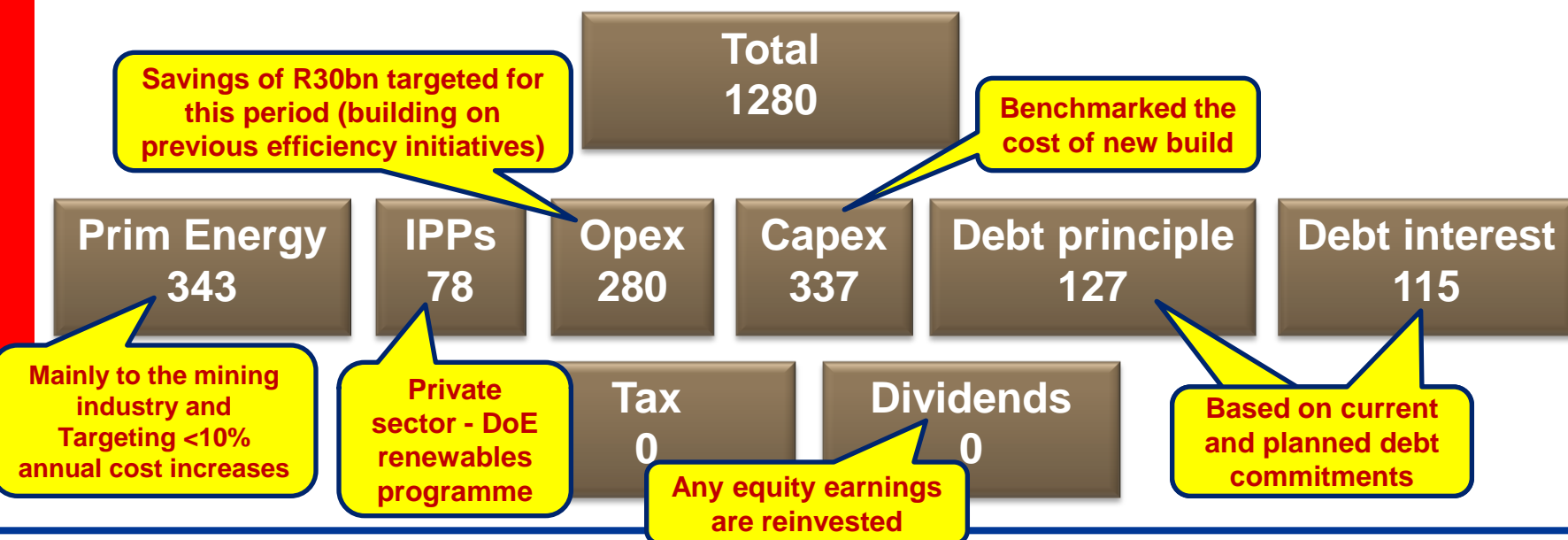


- Every 1% reduction in tariff increases per annum over the MYPD3 period = approximately R25bn lower revenues over the period (excluding IPPs)
- As cash flows need to be balanced, the decline in revenues requires a corresponding increase in debt
- Further equity from the shareholder is constrained

# Balancing the cash requirements in support of the key imperatives (2014-2018 – Rand bn)

CASH INFLOWS

CASH OUTFLOWS

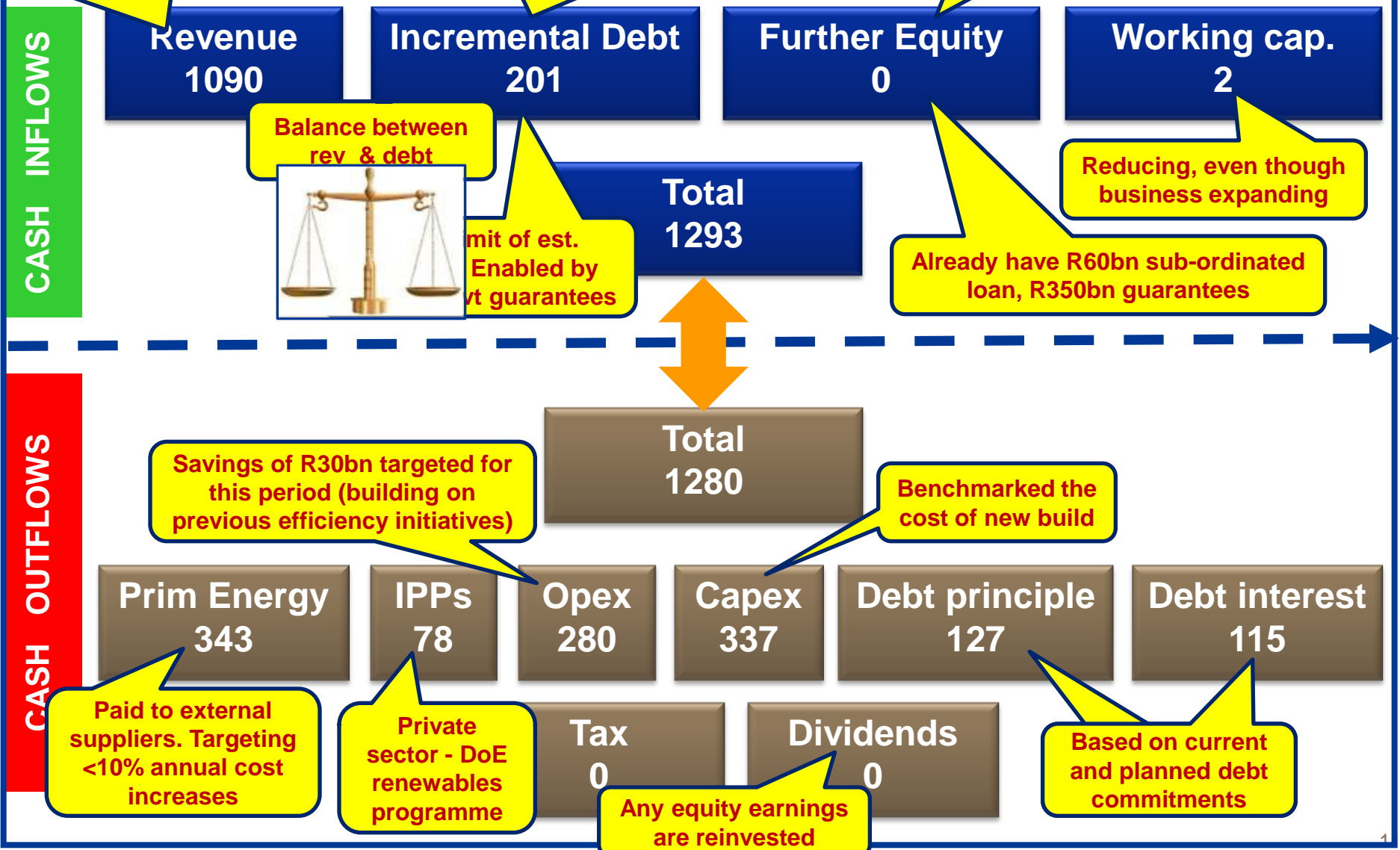


# Balancing the cash requirements in support of the key imperatives (2014-201)

Tariff increases: for every 1% p.a. less than the requested 16% x5, it implies ....

.... approx. R25bn more from debt (to be repaid in future) thus also requires higher guarantees, or ....

.... equity (borrowed by government, repaid by taxpayers)



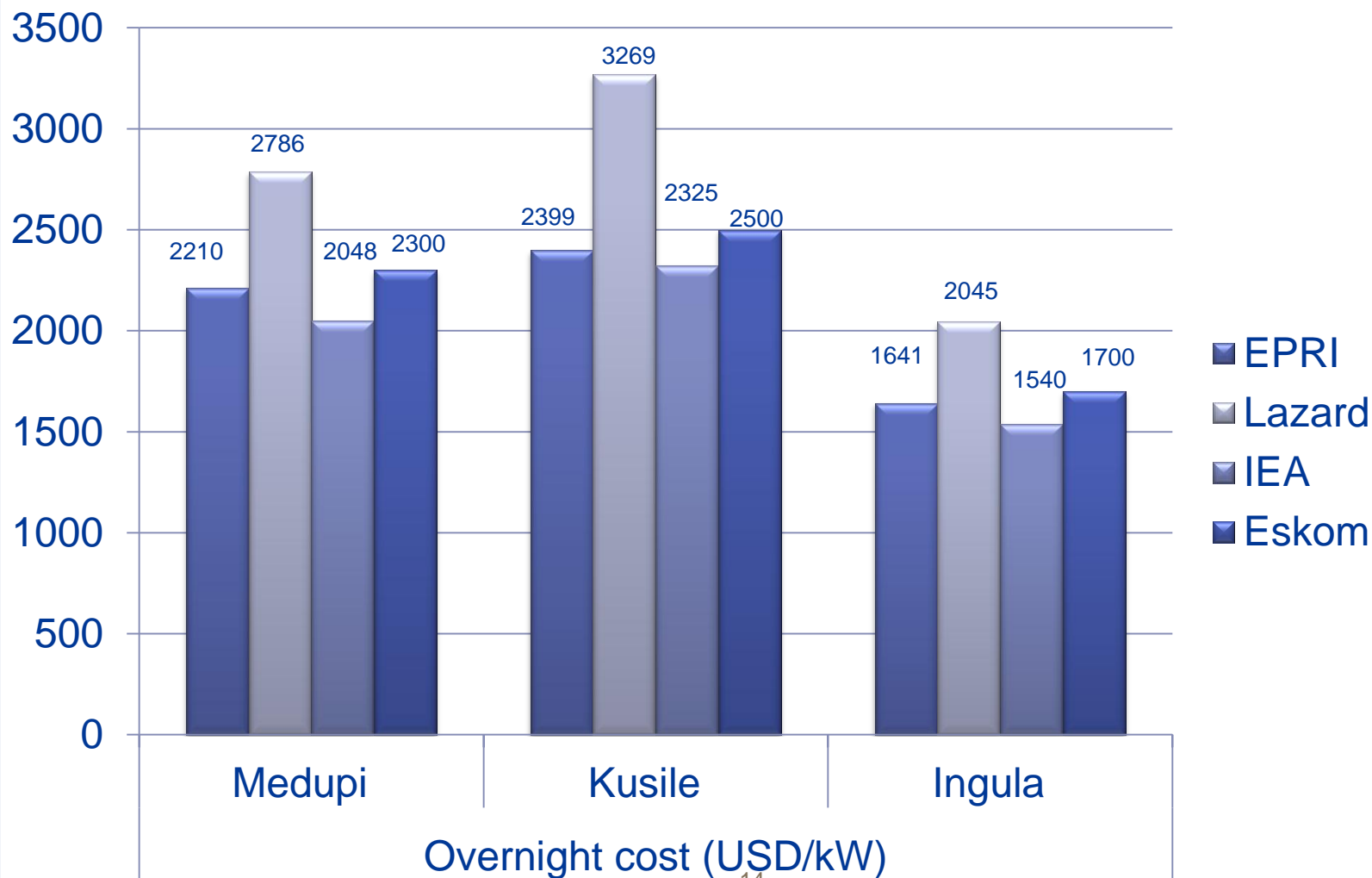


# Efficiency

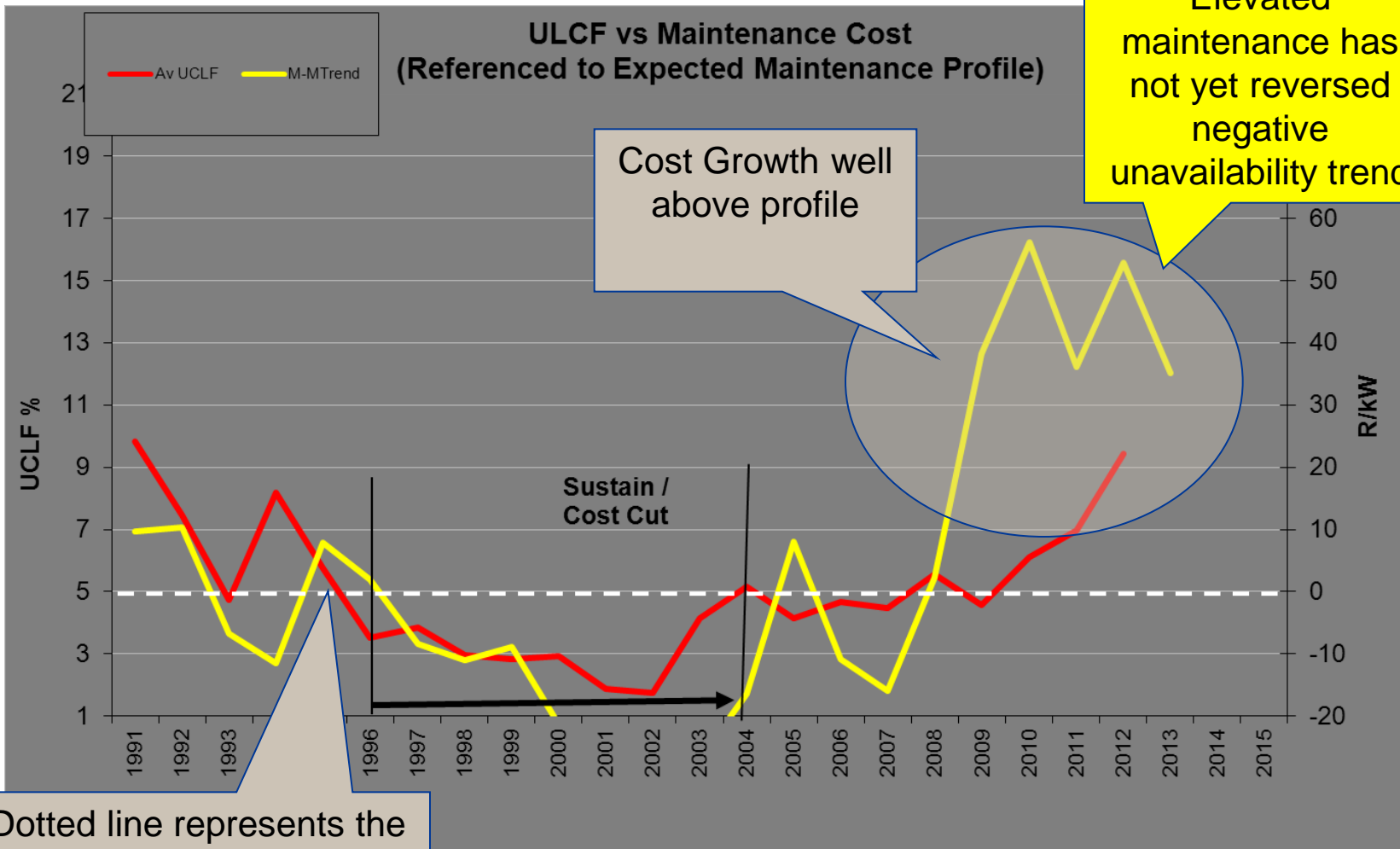
- Eskom has an obligation to continue to strive to improve and become more efficient
- What have we done:
  - committed to R30 billion savings
  - Consequences of an extra R100 billion savings (as indicated by a number of commentators) may result in :
    - Reduced maintenance
    - Reduced training and development
    - Reduced capital expenditure
  - Contained costs increases in application at single digits
  - Focus on coal with mining industry
  - Capital expenditure optimisation initiative
  - Implemented systems and processes to gain efficiencies
  - Will continue to benchmark performance
- Power system is constrained system but performance is still comparable to international benchmarks

# Comparison of Overnight costs between EPRI, Lazard, IEA and Eskom for the New Build Programme

While Medupi and Kusile are similar super-critical coal-fired power stations, the difference in their costs is due to Medupi costs not including flue-gas desulphurisation. The capital expenditure phasing is also different, resulting in Kusile attracting higher escalation and financing charges



# Maintenance cost relative to unplanned unavailability trend. Indicates maintenance no longer effective on its own.

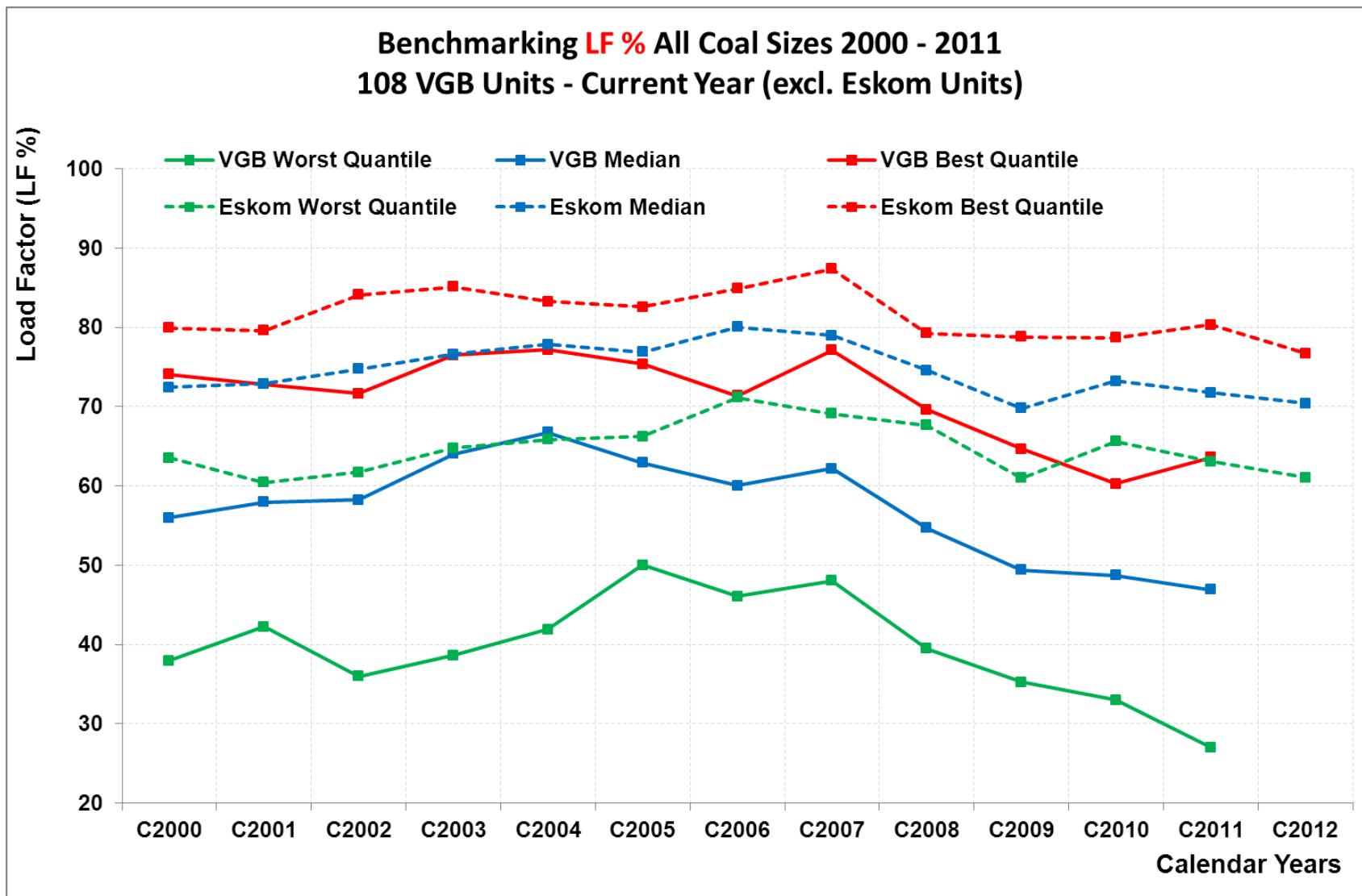


Dotted line represents the prudent maintenance cost profile

Cost Growth well above profile

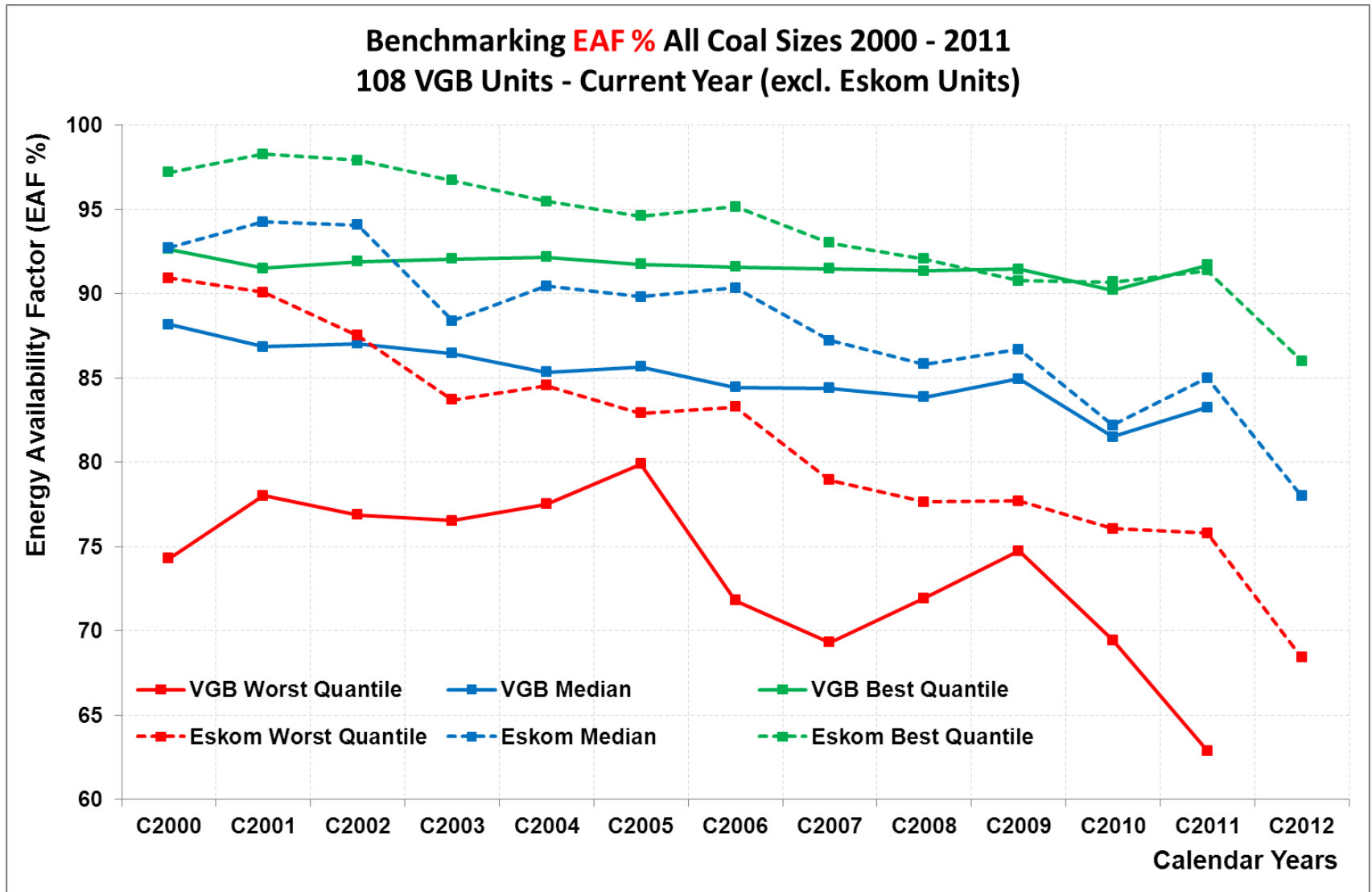
Elevated maintenance has not yet reversed negative unavailability trend

# Eskom plants Load factors higher than European plants





# Energy availability factor (EAF)





# Policy

- Eskom supports the need for integration at a policy level
- Eskom's application is made in line with policy in the electricity sector
- A decision cannot be delayed until all the policy matters are resolved
- Interventions required to protect specific sectors is the responsibility of government

- Review of energy choices and timing
- Consider national tariff framework
- Need for national subsidy framework that is aligned to economic policy which includes industrial and social policy
- Address challenges of local authorities
- Compact with coal industry
- Coal is a strategic resource
- Continue with the efforts to implement metering systems and a regulatory framework to facilitate off-setting of renewable energy by smaller customers



# Conclusion

- We have received a few questions and will respond in writing to Nersa, to the extent that they have not already been covered.
- Several proposals on performance improvements have been suggested by presenters. Eskom will engage with these stakeholders to better understand their proposals.

- Eskom's has a developmental role to grow the economy and improve the quality of life of the people in South Africa
- The increases requested is to enable Eskom to deliver on its mandate
- We have tried to find the optimal balance for South Africa with the application



**Thank you**