

Keynote Address

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The Honourable Minister of Mineral Resources and Energy,
Gwede Mantashe

Chief executives and Captains of Industry

Industry leaders, associates, and experts

Distinguished guests

Ladies and gentlemen

Good afternoon and thank you for affording me this opportunity to engage with you today and share some of the latest developments within Eskom, and within the broader electricity industry.

This year's event is especially important because, if we are to recover from the effects of the COVID-19 pandemic, robust engagements and collaborative partnerships are key.

As announced by Statistics South Africa in early September 2020¹, the gross domestic product (GDP) fell by just over 16% between the first and second quarters of 2020, giving an annualised growth rate of -51%, pushing the country deeper into recession. In the same period, production in the mining sector shrunk by 73,1%, contributing -6,0 percentage points to GDP growth. This is unlike anything we have ever experienced before, and to quote President Ramaphosa, ***"Now is the time to act quickly and boldly to place South Africa on a rapid growth trajectory. We cannot continue with business as usual. We will use this moment of crisis to build a new economy, and unleash South Africa's true potential"***.

Indeed, it is now time, as the President requested, to heed the call ***"to act with unity and purpose to rebuild the economy for the benefit of all South Africans."***

¹ This Statistics South Africa report (published 8 September 2020) is attached as an annexure to this speech and may also be located on the link <http://www.statssa.gov.za/?p=13601>

As Eskom, we understand that we have a critical role to play in enabling South Africa's economic recovery efforts, for without reliable electricity, there can be no sustainable economic recovery.

On this note, it gives me great pleasure to address you on the following key points pertaining to Eskom's operations, particularly our efforts to turn Eskom around. These are:

- Eskom's current strategy and future plans;
- The impact of COVID-19 on Eskom's operations;
- Eskom's procurement policies and sustainable coal supply agreements;
- The cost of electricity and security of electricity supply;
- Eskom's strategy, the Integrated Resource Plan, and the future energy mix of South Africa; and
- Eskom's unbundling plans and the impact of unbundling on Eskom's business model and sustainability.

On Eskom's current strategy and future plans

As part of the Eskom Turnaround Strategy we have focused on **five** urgent and interdependent priorities that require urgent and integrated implementation.

Plans are in place to enable Eskom to achieve **operational stability** and, subsequently, significantly reduce the risk of load shedding. These stem from our Maintenance Recovery Project, which aims to spur midlife refurbishment and conduct reliability maintenance to improve the energy availability factor (EAF). By April of next year, we shall see the first benefits of the enhanced maintenance, and by September of next year, we will have significantly reduced, but not eliminated, the risk of loadshedding.

However, these efforts – to refurbish and maintain the plant and improve the level of performance and reliability – on the part of Eskom by itself are not enough to end load shedding. As a start, a stable supply system on its own brings confidence for business to start investing in new opportunities and the expansion of existing ones, which increases demand and further puts pressure on the infrastructure. South Africa needs additional generation capacity to serve existing demand, and to cater for a growing economy. And we need that additional capacity sooner rather than later.

Eskom was therefore very pleased to note the concurrence of NERSA with the Department of Mineral Resources and Energy's ministerial determination for the procurement of an additional 11 873MW of infrastructure over the years to 2030. We also note the ongoing progress in the emergency procurement of another

2 000 MW of generation capacity, and look forward to continued rapid progress in this regard.

As such, Eskom is looking forward to collaborating with The Department of Mineral Resources and Energy as well the IPP Office to enable an accelerated execution to bring additional capacity onto the grid in the shortest space of time possible. Early alignment and consultation are sure to result in more favourable and predictable outcomes.

Actions geared towards improving our **income statement**, which is under immense pressure, are under way. Eskom's revenue challenges are the result of lower sales volumes, which have seen an annual decline of 1% (for approximately the past 10 years), as well as the non-cost-reflective tariff increases granted by NERSA. Without cost-reflective tariffs, our business efficiency efforts will be of short-term benefit. Eskom has, thus, reviewed various revenue decisions by NERSA through the High Court.

Unfortunately, this has been the only course of action available to a licensed entity in reviewing a revenue decision. Eskom does not want to be in court with its regulator, and looks forward to the appropriate legislative changes to allow for a less adversarial approach to resolving our differences. As we appeal for cost-

reflective tariffs, we also have an obligation to manage our costs properly and in a disciplined manner. We therefore don't ask for tariffs to subsidise our inefficiencies – we ask for tariffs that reflect reasonably incurred costs.

We continue to optimise primary energy costs, reprioritising capital expenditure and optimising contract management as part of our cost-saving initiatives. In this regard, we have started a process of renegotiating coal contracts where the suppliers' profit margins are above the market norm. The savings potential from the renegotiation initiative will be quantified once the negotiations have been completed.

The debt owed to Eskom by municipalities, which continues to increase, is an undisputed threat to Eskom's financial sustainability. As at the end of August 2020, the arrear debt by municipalities was at R31.4 billion.

Eskom simply does not have any other choice but to take action to recover this massive debt. While it gives us no pleasure, in order to accelerate this debt recovery process, the attachment of the bank accounts and seizure of assets belonging to defaulting municipalities have become part of our intensified efforts to collect this unpaid debt. In such a situation, there are no winners.

However, as a country, we must enforce the principle that those who use electricity must pay for it – and that also applies to the denizens of Dainfern! And so, we are committed to continue pursuing all legal avenues to increase collection and appreciate your support in this regard. We are also committed to ongoing engagements with Government and various stakeholders to find a sustainable solution to this problem. The support that we have had from the Political Task Team led by the Deputy President has been instrumental in enabling us to carry out this work with resolve.

Focused actions to address Eskom's **balance sheet** are in progress. Our financial modelling illustrates that Eskom CAN only achieve independent financial sustainability if its debt balance is reduced to R200 billion, a closing cash balance of R30 billion, and an EBITDA margin of 35%. Our debt was a staggering R488 billion as at end March 2020; as you may imagine, the interest bill on this is unsustainable, and requires us to borrow money to pay interest. While the equity assistance from National Treasury continues to be an indispensable source of support for Eskom, it is clear that a structural solution must be found, and we are encouraged by the positive progress made at Nedlac in this regard.

The Just Energy Transition (JET) Transaction is among a range of actions taken to mitigate the need for fiscal support dependency in the future. While contributing to the country's energy mix, the JET will create innovative and forward thinking revenue streams which will further assist us in optimising our balance sheet. Eskom is the first SA business to establish a JET Office to drive this catalytic intervention. JET is but one intervention to capitalise on the groundswell for green financing, and Eskom has received a number of firm indications of support from international and local developmental financial institutions who are interested in enabling a just transition to a lower carbon future.

We have also embarked on a decisive journey towards restructuring Eskom into Generation, Distribution, and Transmission, with **divisionalisation** as the first step. Notable progress has been made on the 2019/20 targets of this crucial phase towards the legal separation of Eskom's three main businesses, in line with government's "Roadmap for Eskom in a Reformed Electricity Supply Industry", released in October 2019. We are also accelerating our efforts to establish a separate legal entity for Transmission, and have approached DPE and National Treasury for the necessary approvals under the PFMA to create a new wholly-owned subsidiary under Eskom Holdings SOC for this purpose.

The Integrated Resource Plan of 2019 (IRP 2019) calls for the Single Buyer Office to be reconfigured in accordance with the divisionalisation efforts. In light of this, the office is being restructured into a central purchasing authority, with new inputs around rules and processes, to ensure greater transparency and efficiency.

On the topic of Eskom's organisational culture, we have acknowledged that organisational culture will take shape irrespective of whether leaders have played an active role in driving desired behaviour, values and work ethic. In other words, business culture will form even when leaders do nothing. If we continue to leave Eskom's organisational culture unattended, this has the potential to sink our business and severely compromise our value-add to the country.

Thus, we have recently taken some bold decisions to restructure our staff. These decisions have included, inter alia, the movement and rotation of staff, the reconfiguration and integration of certain functions, and the implementation of consequence management and disciplinary action for the failure to discharge critical duties in a quality manner. Additionally, I personally make available around an hour and a half every week to talk to employees who have distinguished themselves with their contributions to Eskom. After

all, we should spend as much time catching employees doing things right as we do trying to catch those who do things wrong.

The late Peter Drucker (one of the most globally recognised and influential thought leaders on management) was famous for saying, “***Culture eats strategy for breakfast***”, something with which I wholeheartedly concur. In other words, irrespective of the investment made to develop plans and strategies, none of these will amount to anything if we do not have the right business culture. Having said so, let us also appreciate that organisational culture is not something that we are going to transform overnight and that there is no single silver bullet that will bring about the desired changes. Instead, we acknowledge that transforming Eskom’s organisational culture will require a deliberate, consistent, sequenced and systematic effort.

While dealing with the issue of performance and building a business culture embedded in Eskom’s six values (namely Zero Harm, Innovation, Integrity, Sinobuntu, Customer Satisfaction and Excellence), we have also made efforts to reverse the rot of corruption and corruption. The issuing of summonses against 12 defendants (in this case, former Eskom employees and Board members) associated with state capture is a critical step in this effort. This is another example of steps we are taking to rebuild trust amongst our employees and customers and restore public

confidence in Eskom. We will continue to pursue those who have sought to enrich themselves at the expense of Eskom, and are about to step up our legal processes to deliver these outcomes.

On the impact of COVID-19 on Eskom's operations

The impact of COVID-19 Year-To-Date (YTD) on Eskom's finances is seen on lower sales, resulting in lost revenue of approximately 7% (of revenue) for the period to August. By Year End (YE) this is expected to reduce to 5% due to the relaxing of the lockdown levels and the re-opening of the economy.

Additionally, there has been some offset from lower operational costs associated with lower production volumes and the impact of slower maintenance during the earlier lockdown levels, with spend being approximately 7% lower than cost budgets in the YTD, and forecast to be 2% lower by YE.

On the maintenance front, the Generation Reliability Maintenance Programme (which focuses on long-term, detailed maintenance), was significantly affected during the higher alert levels of the lockdown with stringent restrictions. Instead of idling and taking a back seat during this time, Generation used the hard lockdown

period to execute short-term maintenance. I am pleased to inform you that our long-term reliability maintenance activities have been in full effect from 1 July 2020, and we are confident that we can expect to see significant improvement in the system by September 2021.

On Eskom's procurement policies and sustainable coal supply agreements

Eskom has sustainable and long-term coal supply agreements in place. Our coal procurement strategy is based on pursuing long-term contracts to achieve the optimal volume mix over the life of the power stations. However, coal has also been secured to meet our needs in the short term.

We are in the process of implementing a long-term coal strategy, which will ensure a predictable coal price path and security of coal supply. The strategy will give preference to dedicated long-term coal contracts, where coal is delivered by means of conveyor belts.

Through this strategy, we aim to recapitalise the cost-plus mines to alleviate contractual shortages. The process to extend the cost-plus contracts to match the life of the reserve and the power stations has already begun. This will limit road transportation, as the coal is delivered via existing conveyor infrastructure. As you

are aware, road transportation of coal has been associated with several accidents and deaths over the years, which is unacceptable. We need to find ways to bring coal to our power stations without compromising public safety and infrastructure. Regrettably, our efforts to transfer coal from road to rail at the Majuba Power Station have been delayed for months while awaiting procurement approvals from National Treasury.

We have also initiated the means to extend the existing long-term fixed-price contracts for designated power stations, capitalising on the close proximity of the colliery and the conveyor mode of delivery. In addition, we are engaging in a robust open tender process to source coal for the remaining life of the power stations.

To this end, we have already issued four invitations to the market to tender for the supply of approximately 250 million tonnes of coal to several power stations over 20 years and approximately 13 million tonnes of coal to supply Camden Power Station over five years.

The coal procurement strategy also entails incentivising suppliers to develop new mines with a predictable long-term Eskom offtake and a potential to export the balance of coal to earn premium returns. Eskom and the cost-plus mines are currently exploring

technical options and conducting studies to determine the most economically feasible options.

Ladies and gentlemen, the above steps underpin Eskom's efforts to have dedicated long-term coal contracting, with a preference for coal delivered on conveyor belts and for a predictable price path necessary for a regulated entity.

With this said, it is also important to highlight that Eskom's coal procurement is governed by the Preferential Procurement Policy Framework Act, which by law, must be considered in the modelling of the domestic coal trading platform.

On the cost of electricity and security of electricity supply

Our Turnaround Plan, which is currently in effect, is geared towards improving Eskom's performance to achieve sustainability and guarantee security of electricity supply. Amongst our initiatives is the repurposing of some of our older coal-fired power stations to natural gas, renewables, and biomass-to-energy, among other options, to boost capacity.

As you may be aware, we have already issued a request for expressions of interest and proposals for the repurposing of the Komati, Hendrina, and Grootvlei Power Stations.

Eskom is one of the last remaining vertically integrated electricity utilities in the world. As the structure of the global electricity industry is fundamentally and rapidly changing owing to new technologies, increased pressure to reduce emissions, distributed generation, and capital constraints, Eskom too needs to embrace this change. The repurposing of the older coal-fired station is one of the positive steps being made in this regard.

Through our Transmission Development Plan (TDP), we aim to increase the transmission infrastructure by approximately 6 700 km of high-voltage lines and 41 000 MVA of transformer capacity in the next 10 years. Coupled with the maintenance of our Distribution network and improved Generation performance, this significantly supports our efforts to ensure a secure supply of electricity in the long term. Eskom also continues to strengthen the grid to accommodate the new power plants and fulfil its current role as the single buyer of power produced by the independent power producers (IPPs).

In terms of electricity pricing, South Africa's commercial and industrial electricity tariffs are competitive by international standards.

In a study undertaken by Statista in 2018, results indicated that Eskom's and even South African (including municipalities)

average electricity prices are relatively low, when compared to other countries in the world.

In a recent 2020 report by NOVA Economics, a comparison across 100 countries showed that South Africa's average price ranked competitively across all three of the main customer segments – industrial, commercial, and residential.

These studies have taken into account the mark-ups added by municipalities and is not exclusively focused on Eskom tariffs. South Africa's residential consumers pay an average of 133,67 c/kWh, which (believe it or not) is a lower tariff than more than half (53 of 100) the countries surveyed. South Africa's average commercial tariff of 122,96 c/kWh is cheaper than 71 of the 100 countries surveyed, while industrial tariffs are among the lowest 20 countries surveyed, at 76,32 c/kWh.

Closer to home, in 2016 the World Bank undertook an analysis of electricity utilities in 39 countries in sub-Saharan Africa, which included an assessment of their operational and capital expenditure. The study came to the conclusion that South Africa's electricity costs were very low relative to other sub-Saharan African utilities (the third lowest to be precise).

Similarly, compared to other utilities in the sub-Saharan region, Eskom's electricity price is relatively low. The current average selling price is R1,02/kWh, and this is below the levels required to be cost-reflective.

The government's Integrated Resource Plan (IRP), as published during 2019, indicates that the average price of electricity is approximately 133 c/kWh (for all customers) in 2020. Compared to Eskom's average of 102 c/kWh, this represents a R67 billion revenue shortfall for the 2020 financial year and over R300 billion in revenue shortfall over the last 10 years. The annual revenue gap of R60 billion exceeds Eskom's annual cost for operating, maintenance, and employee benefits. This situation does not augur well for the sustainability of Eskom. Bear in mind that back-up power is much more expensive than grid power, even at cost-reflective levels. The cost of unreliable electricity is much higher than appropriately priced electricity!

On Eskom's strategy, the Integrated Resource Plan, and the future energy mix of South Africa

Eskom fully supports the government's Integrated Resource Plan of 2019 (IRP 2019), which signalled an important move to a wider range of fuel options for power generation in the country, and supports a diverse energy mix, sets out nine policy interventions to ensure security of SA's electricity supply. We have a

potentially important and enabling role to play in the implementation of the plan.

Some of the many ways of doing this include repowering our older power stations with cleaner-fuel technologies and renewables as well as the development of renewable projects on available land around each of the power plants. In this way, we will be taking advantage of existing transmission infrastructure, networks and connections to continue extending economic opportunities to those communities who have supported Eskom over the past 50 years.

These proposals are part of our Just Energy Transition Project. It should be noted, however, that any transaction involving any of these options would be subject to Shareholder and regulatory approval, as well as consultation with the affected communities and organised labour.

On Eskom's unbundling plans and the impact of unbundling on Eskom's business model and sustainability

To remain a competitive, profitable, and reliable supplier of electricity to South Africa, we need to ensure that we run Eskom in an effective and efficient manner. As briefly mentioned earlier, the unbundling of Eskom as envisioned in the "Roadmap for

Eskom in a Reformed Electricity Supply Industry” will enable Eskom to achieve this by increasing accountability and transparency, while driving operational improvements and effectiveness.

We have begun to see some progress with the appointment of the divisional Boards and managing directors in Distribution and Transmission, and the recruitment process for the managing director for Generation is currently under way. These Boards are mandated to run the various divisions as independent entities, while aligning themselves with the Group strategy under Eskom Holdings.

As part of the restructuring process, which is still in the divisionalisation phase, Eskom has ring-fenced the financials of each of the divisions and for the first time, is currently reporting separate financial statements. This includes a reflection of the debt and associated debt costs attributable to each of the divisions, providing the required transparency. However, during this divisionalisation phase, the actual debt holding is still at an Eskom Holdings level.

Furthermore, the internal energy trading process has been reinstated in Eskom to enable full transfer pricing together with corporate cost allocations to each division.

The end state of the unbundling process will be the legal separation of the three entities under Eskom Holdings, which will commence after the completion of the divisionalisation phase, once the required legal framework is in place and Eskom is financially sound.

Minister, distinguished guests, ladies and gentlemen, while we have a clear strategy in place, we fully appreciate that the next few years will pose formidable challenges in Eskom's operations, but these are NOT insurmountable.

Amidst our many challenges, it is sometimes easy to forget what a remarkable and life-changing organisation we serve at Eskom. Our service to Eskom fuels and grows our country's economy, allowing businesses to operate and create employment, which enables families to survive the scourge of poverty and thrive. When Eskom functions and performs optimally, we become a powerful lever to mobilise these important national priorities.

Therefore, it is imperative for those who serve Eskom, to understand the direct impact that we have on the lives of all South Africans. Conversely, when Eskom's performance and processes are compromised, resulting in loadshedding or perhaps necessitating additional fiscal allocations from the National

Treasury, we acknowledge that we would have played a role in depriving South African families and draining the national fiscus of funds. These are funds that would have been allocated to other important national projects, such as feeding schemes for children or housing developments. I for one am deeply aware of the negative impact that this has on the poorest of poor, and am therefore all the more resolute to address waste and improve our efficiency.

Through our collective abilities, we remain resolute to achieve operational and financial sustainability to regain Eskom's reputation as South Africa's trusted and credible electricity supplier.

Lastly, I would like to leave you with quote by Ben Okri that I have always found to be profound and inspirational, and it also happens to be one that is poignant and powerfully appropriate for Eskom: "***Our future is greater than our past***".

I thank you.

The End