

Proposed Address
Mr Jabu Mabuza, Eskom Interim Board Chairman and
Acting Group Chief Executive
FY2019/20 Interim Results Announcement
28 November 2019

Members of the Eskom Board

Officials from DPE

Eskom executives and staff

Members of the media

Esteemed guests

Ladies and gentlemen

Good afternoon

Ladies and gentlemen, we had the privilege of hosting His Excellency, President Cyril Ramaphosa, and his delegation at the Medupi Power Station on Tuesday, serving as assurance of Eskom's strategic contribution to the economy of South Africa.

Being mindful of this level of appreciation of Eskom's role in the success of our country, we always endeavour to keep our

stakeholders and fellow South Africans reliably informed about our business. Accordingly, the results we share today are a true reflection of Eskom's operations.

Ladies and gentlemen, since we shared our annual results in July, there have been some notable developments and key milestones in relation to Eskom's turnaround journey that are worth reflecting upon:

- The promulgation of the Integrated Resource Plan (IRP) set the base for much-needed policy direction in the future of the country's energy mix. This in turn enables Eskom to plan properly for the integration of additional capacity.
- The approval and launching of the Special Paper on Eskom have set the tone for the restructure of Eskom within a reformed electricity industry structure. This in turn enables Eskom to execute on the turnaround journey that is underpinned by this industry reform.
- The appointment of the Group Chief Executive of Eskom brings further leadership stability to our business and enables us to advance towards a sustainable future. We are fortunate to have the expertise of an experienced

leader such as Mr André de Ruyter to steer Eskom towards achieving our vision for the future.

- The office of the Chief Restructuring Officer has been set up to work with government in finding a sustainable solution to our debt problems. In this regard, we await the completion of the work of the CRO's office so that we can give further details about the plans to deal with Eskom's capital structure in the most effective way.
- Of equal importance is the approval by government of the Special Appropriation Act which will provide for government to allocate further fiscal support to Eskom for the 2019/20 and 2020/21 financial years.
- Though the government has pledged its support, it goes without saying that Eskom requires a cost-reflective tariff increase. It is for this reason that Eskom is challenging Nersa's recent tariff decisions in the High Court. We are pleading for a tariff increase that is consistent with the Multi-Year Price Determination (MYPD) methodology. At the end of the day, we have to achieve a financial turnaround and business sustainability. These two factors underpin our commercial and developmental mandate.

- In view of the arrear debt by municipalities and individual users, which continues to escalate, it is encouraging that President Ramaphosa has recently called on all citizens to pay for the services they receive. Eskom will also continue discussions with government through various formal structures in an endeavour to find a lasting solution to this national problem.

Ladies and gentlemen, while we continue to face operational and financial challenges, for the interim reporting period ending September 2019 we are proud to have realised a healthier EBITDA of R30.6 billion (compared to R28.3 billion in September 2018) and a net profit of R1.3 billion (R627 million in September 2018). We, however, have a peculiarity in that generally EBITDA and cash from operations should be very similar. However, in our case the EBITDA is R30.6 billion while cash from operations is significantly lower at R19.7 billion largely due to the coal stock pile build up. This is not sufficient to cover depreciation and net finance costs. Hence our financial ratios have remained weak with a significantly higher cash shortfall.

Calib will speak about the detailed interim numbers, but I believe it is important for us to, over and above that, also contextualise our expectations for the year ending March 2020.

At this stage, we expect to report a loss with the same margin as last year. There are a few contributing factors in the second half of the financial year that can be summed-up as follows:

- **Revenue**

There is a huge variance in electricity sales volumes during the winter and summer period. Eskom is a cyclical business with sales in the first half of the year more than in the second half, mainly as a result of the higher demand in winter.

In addition, the average winter price is higher than the summer price.

The net impact on revenue is R16 billion, of which R2 billion is as a result of lower volumes and R14 billion due to the lower summer prices.

- **Primary energy costs**

Despite production from coal sources being lower in the second half of the year due to increased maintenance of coal-fired plants, coal expenses are projected to have a negative effect on the financial performance for the second half of the year.

In addition, the nature of renewable plant technology, especially the solar PV, means higher utilisation in the summer months

which in turn increases IPP cost contribution to overall primary energy costs.

In the unfortunate circumstances of increased unplanned breakdowns, as we have seen recently, Eskom extensively make use of the open-cycle gas turbines (or OCGTs) to stabilise the power system, and this is a costly exercise. In addition, there is a need to improve our stock piles and keep them at acceptable levels at a time of the year where inflation-based increases see the price of coal going up. The net increase in coal burn cost is expected to reach R3.8 billion the end of the financial year.

All of this combined has a negative impact on Eskom's primary energy costs.

- **Employee benefits**

The 7% annual salary adjustments for Bargaining Unit or non-managerial employees according to negotiated wage agreement as well as the 2.8% for EMPSG or managerial employees will also reflect in the year-end results.

- **Maintenance costs**

Eskom continues to experience higher maintenance costs linked to additional funding provided in the plan as a result of the Generation Recovery Programme (or 9-Point Plan) and the strengthening of our transmission and distribution networks in support of operational recovery. The increased unplanned breakdowns also result in additional spending. Over and above the excessive usage of OCGTs to supplement the system, to fix and bring the units back online has associated expenses.

- **Escalating arrear debt**

The arrear debt by the country's municipalities continues to rise. Invoiced municipal arrear debt increased by R5.2 billion from March, reaching a high of R25.1 billion in September, including interest. While the focus has been on non-paying municipalities, the payment levels of a number of municipalities, including those who are serving their debts, is not satisfactory.

The payment rate by municipalities, excluding metros, on amounts billed is at 78%. This is a decline from 93% four years ago. The ideal payment rate is 100%, whereby municipalities pay the entire amount due to Eskom on time. The top 20 defaulting municipalities have a payment level of 44%.

Ladies and gentlemen, combined with other factors, these will also affect our EBITDA negatively and negate the commendable financial performance of the first six months –

ending September 2019. Further, our debt service obligations largely fall within the second half of the financial year, putting more pressure on our bottom line and liquidity.

It is against this background that while a net profit of R1.3 billion was realised by September, a R20 billion loss is projected by year end.

Our overall interim performance remains unfavourable, as we continued to face operational and financial challenges characterised by weak financial ratios as well as a constrained and vulnerable power system.

The generating plant performed at low levels of reliability and Transmission's performance deteriorated as a result of severe network failures. Unplanned maintenance reduced the Energy Availability Factor (EAF) to 70%, from 75% in the same period last year.

On the financials, we face the reality that the organisation must borrow to service its debt. Our existing cost base simply cannot accommodate sufficient efficiencies to bridge the revenue gap.

In addition, Moody's Investors Service recently downgraded our unguaranteed credit. Although the downgrade was announced

early this month, it was due to factors arising in the past, including the period under review.

While we note Moody's decision with disappointment, we acknowledge the concerns raised and continue to work closely with shareholder ministries to resolve them.

We also view Moody's comments on Eskom's governance issues as an affirmation of the progress made with resolving our corporate governance challenges.

Ladies and gentlemen, in spite of facing a number of challenges, we are making notable progress in some aspects of our business. As at the end of September, we have already secured 61% of the funding requirements for the 2019/20 financial year.

We also continued to implement the Generation Recovery Programme that helped us through the winter period without the need for loadshedding.

There is some improvement in the availability of new build units as some defects were effectively addressed.

As we continue to implement the Generation Recovery Programme, our main focus remains to improve the EAF, and

to do this we need to double our efforts to fix our plant, notwithstanding the fact that we are managing an aging fleet, with an average age of approximately 37 years. Unplanned breakdowns should be at 9 500MW while we carry out an average 5 500 MW of maintenance at the generating plants. Increased breakdowns require the use of emergency resources at a high rate.

It also increases the probability of loadshedding if the supply constraints are sustained for a longer period. The heightened maintenance will also happen against the summer-specific challenges. For instance, it is during summer when we experience “vacuum load losses” occasioned by ambient air temperatures and wind direction that have a negative impact on the efficiency at some of our coal-fired plants, such as Matimba.

On the positive side, contrary to the same period last year, the shortage of coal is no longer one of our problems. The number of power stations with coal stock below the minimum levels has been reduced from nine in March 2019 to only one station at the end of September.

Eskom’s overall level of stockpiles improved from 36 days in March to 54 days at the end of September.

The appointment of Bheki Nxumalo on 1 July 2019 as Group Executive for the Generation Division also brought much-needed stability to the Division.

The Koeberg Power Station has been operating efficiently while the Distribution networks continue to deliver a stable performance. Good progress has been made at Medupi and Kusile, resulting in a significant contribution from both commercial and non-commercial units among the power stations.

Year-to-date, we brought two units from Medupi Power Station into commercial operation, with Unit 2 attaining commercial operation status on Tuesday this week. The unit now forms part of Eskom's generation output contributing about 794 MW to the South African power grid. Medupi's Unit 3 went into commercial operation in July, also adding about 794 MW of power to the national electricity grid. We have also synchronised Kusile's Unit 3 to the national grid in April, followed by the last of the six Medupi Power Station units, Unit 1, in August.

In addition, 45 kilometres of high-voltage transmission lines were commissioned, further strengthening the network.

These are significant achievements which talk to our commitment to expedite the completion of the long overdue build program and in turn alleviate the pressure on supply.

In relation to our clean-up efforts, we have completed lifestyle audits of executive senior managers. Cases flagged as high-risk were handed over to the Special Investigations Unit (SIU) for further investigation, and we are awaiting feedback. We furthermore finalised a total of 145 investigations into fraud, corruption, and irregularities, with disciplinary action recommended in 122 of these cases.

Our governance clean-up efforts continued to yield desired results. The High Court has ordered Trillian to repay R600 million it received from Eskom between August 2016 and February 2017 in the absence of valid contracts and, in some cases, where no work was done. Although Trillian has appealed the judgment, we are optimistic about a positive outcome. We successfully recovered one billion rand from McKinsey through similar processes earlier this year.

Eskom has also issued court papers to set aside contracts and recover R207 million from Deloitte Consulting for improperly awarded work. We remain committed to recover monies from whoever unduly benefitted from Eskom.

While we have no doubt that we will continue to confront headwinds, we remain committed to making the bold and difficult decisions that will ensure that Eskom fulfils its commercial and developmental mandate, and regain its reputation as South Africa's trusted and credible electricity supplier.

We concede that Eskom's turnaround remains a difficult journey. So much still has to be done to build on the improvements we have already made. This will continue to require a partnership approach among all stakeholders, where difficult choices will have to be made, with the aim of achieving sustained success.

The ultimate goal is to make Eskom a profitable, transparent, agile and top-performing organisation that is financially independent.

Before I request the CFO to give an overview of our results, I wish to convey my sincere thanks to the Eskom leadership for their continued and unequivocal support. I equally thank all the Eskom employees for their resilience, dedication and commitment to keeping the lights on, to power our great nation.

I personally thank them for taking on their task with diligence amid all the challenges.

I also thank my colleagues on the Eskom Board for their strong support and for giving direction.

My sincere appreciation also goes to our customers, stakeholders and all South Africans for being patient with us.

We remain grateful to the shareholder for the ongoing support as we go through a tough, and arguably the most uncomfortable phase in the organisation's 96-year history.

Lastly, I want to reiterate the importance of leadership stability as a critical factor in Eskom's turnaround.

With that in mind, it would be remiss of me not to deal with the issue of the appointment of the new GCE, which caused much excitement in many quarters.

I, on behalf of the Eskom Board, wish to convey our congratulations to Mr André de Ruyter on his appointment as the Group Chief Executive. I thank André for putting up his hand up to take on this monumental task and wish him well in his new role as I pass the baton to him.

I thank you.