Eskom | 100 1923-2023

COMMENTARY ON INTERIM RESULTS

FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2023

EAF worsened further to
55.30%
(Sep 2022: 58.66%)

Loadshedding on
183 days
(Sep 2022: 102 days), despite extensive OCGT usage

Emissions performance deteriorated to
0.92kg/MWhSO
(Sep 2022: 0.45kg/MWhSO)

Transmission
network reliability
performance declined

Distribution
network
performance remained stable

1 employee fatality
(Sep 2022: 1 employee and 1 contractor)

Lost-time injury rate declined to
0.28
(Sep 2022: 0.26)

Net profit after tax reduced to
R1.6 billion
(Sep 2022: R3.8 billion)

Tariff increase of
18.65%
(Sep 2022: 9.61%)

Arrear municipal debt escalated further to
R70 billion
(Mar 2023: R58.5 billion)

R78 billion
Government debt relief committed for FY2024

Gross debt securities and borrowings (including subordinated Government loan) of
R442.7 billion
(Mar 2023: R423.9 billion)

The following commentary provides an overview of our financial and operational performance for the six months ended 30 September 2023, as well as progress on other key matters. Developments after the end of the period to the date of approval have been discussed where relevant.

This commentary accompanies the consolidated interim group financial statements which are available at www.eskom.co.za/investors/integrated-results/

Plant availability has continued to decline, resulting in more frequent loadshedding at higher stages on average than in the previous year, requiring stage 6 loadshedding on 47 days (September 2022: 6 days). Furthermore, we have continued to experience the adverse effects of these generation supply constraints on financial performance, mostly due to the reliance on expensive production from Eskom-owned and independent power producer (IPP) open-cycle gas turbines (OCGTs). This situation will continue until Eskom's plant availability improves to expected levels and South Africa's generation capacity shortages are alleviated.

FINANCIAL PERFORMANCE

FINANCIAL RESULTS

Eskom recorded a net profit after tax of R1.6 billion for the period (September 2022: R3.8 billion) while navigating a very challenging operating environment, with frequent supply constraints which continue to have an adverse impact on the economy. EBITDA and profitability were negatively affected by the impact of load curtailment and loadshedding on revenue through lower sales volumes because of unserved energy. Furthermore, production costs did not reduce in proportion to the decline in sales volumes and revenue, largely due to reliance on more expensive sources of production such as OCGTs to reduce the impact of loadshedding.

Revenue grew to R158.6 billion (September 2022: R144.8 billion), an increase of 9.5%, due to the favourable impact of the tariff increase for the 2024 financial year, partially offset by a decline in sales volumes. An amount of R10.7 billion could not be recognised as revenue in terms of accounting standards due to non-collectability from municipal and residential customers (September 2022: R9.1 billion). Of this, R4.4 billion was subsequently recognised as revenue on a cash basis once payment was received (September 2022: R3.8 billion).

The fifth multi-year price determination (MYPD 5), together with the outcome of successful court review applications, resulted in an increase of 18.65% for standard tariff customers supplied directly by Eskom from 1 April 2023, and an increase of 18.49% for municipal and metropolitan distributors from 1 July 2023.

Sales volumes declined by 5.9% to 91.9TWh (September 2022: 97.6TWh), with local and international sales decreasing by 5.1TWh and 0.6TWh respectively. The decline was largely a result of supply constraints, which led to loadshedding and load curtailment, coupled with lower electricity demand from customers at times due to difficult economic conditions and the impact of increased embedded self-generation such as solar PV and wind. However, sales volumes would have declined further without the increased use of OCGTs to minimise loadshedding.

We experienced a decline in sales across every major customer category, apart from the mining sector that saw increased demand arising from higher production due to favourable commodity prices. Ongoing risks for sales volumes include continued generation supply constraints, the impact of embedded self-generation, as well as theft through illegal connections, meter tampering and ghost vending, which are recognised as non-technical losses.

Primary energy costs grew by 10.1%, increasing to R85.1 billion (September 2022: R77.3 billion). This was despite a 5.3% decrease in production, from 114.1TWh to 108TWh, largely arising from poor generation performance at Eskom's coal-fired power stations, requiring the use of production from more expensive OCGT and IPP sources. We experienced a 5.6% growth in coal generation costs arising from inflationary cost pressures, driven by a 10.2% increase in the coal purchase price. Expenditure on IPP programmes other than OCGTs increased to R17.4 billion, largely due to higher production of 8.9TWh from these sources (September 2022: R15.2 billion to produce 7.7TWh)

A combined R18 billion was incurred to produce 2.9TWh from Eskom-owned and IPP OCGTs (September 2022: R15.8 billion to produce 2.1TWh). Favourable diesel price movements during the past six months enabled higher production from OCGTs than originally anticipated. Delays in other IPP programmes, such as the Standard Offer Programme, Emergency Generation Programme and the Risk Mitigation IPP Procurement Programme (RMIPPPP), which have not yet delivered capacity in line with expectations, further contributed to the reliance on OCGTs during the period.

Employee benefit costs increased to R17.4 billion (September 2022: R16.2 billion), largely due to a salary adjustment of 7% for employees, except for top management, in the latter half of the 2022 calendar year. This was necessary to support Eskom's operational stability following the protracted dispute with organised labour, which led to industrial action and widespread disruption of our operations in the prior year. We were able to contain the salary adjustment to inflationary levels and absorb the increase through savings in other areas.

Other operating expenditure increased to R17.3 billion (September 2022: R15 billion), mostly due to a R1.7 billion increase in repairs and maintenance. Generation has continued to conduct extensive maintenance to address plant performance challenges in line with the Generation recovery plan, and additional unplanned maintenance has been required to address several critical plant components.

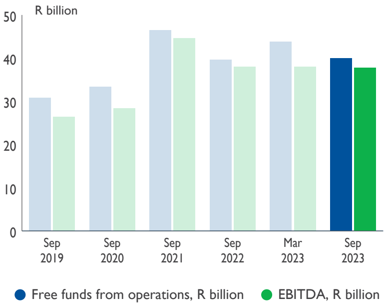
Altogether, these factors led to a slight decline in EBITDA to R37.7 billion (September 2022: R38 billion) along with a corresponding worsening in the EBITDA margin to 23.79% (September 2022: 26.21%). Profit before tax declined to R2.3 billion (September 2022: R5.3 billion) after accounting for growth in depreciation to R16.8 billion (September 2022: R15.8 billion) and net finance costs to R19.7 billion (September 2022: R17.5 billion).

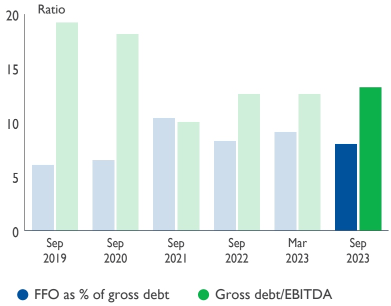
MANAGING LIQUIDITY

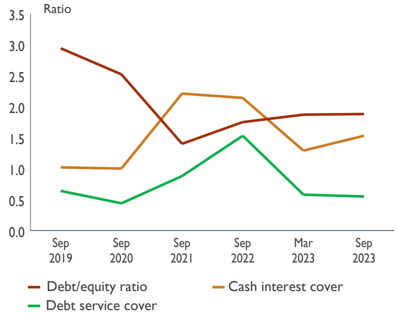
Liquidity remains one of our biggest short-term challenges, limiting our ability to achieve financial and operational stability. As mentioned, poor generating plant performance and depressed economic conditions continue to have a direct impact on financial sustainability, requiring us to make difficult trade-offs between liquidity, the utilisation of OCGTs to minimise loadshedding for the benefit of the economy, as well as accommodating spend on our operational recovery and capital expenditure programmes.

Our financial performance also remains hampered by an inadequate tariff path, above-inflationary cost increases, non-payment by some customers as well as high debt servicing costs. Our turnaround plan focuses on addressing these key areas through the Government debt relief, the municipal debt relief programme, as well as a migration to cost-reflective tariffs and challenging NERSA's decisions in court.

Eskom's liquidity position increased from R7.5 billion at 31 March 2023 to R16.4 billion at 30 September 2023. To ensure deleveraging of Eskom's balance sheet over time, the conditions of Government's debt relief place strict restrictions on Eskom's Generation capital expenditure and prohibit any new borrowings during the debt relief period, unless written permission is granted by the Minister of Finance. Given the restriction on new borrowings, we anticipated facing additional liquidity risk during the first quarter of the year while awaiting the first tranche of support from Government.







To manage this risk, we raised an additional R16 billion in funding from private placements at the end of the 2023 financial year with the support of National Treasury, and received the related disbursements in early April 2023, which bolstered our liquidity position.

Government has committed a total of R78 billion in debt relief for the 2024 financial year, of which R16 billion was received in August, R20 billion in October and R5 billion in December 2023, with the remainder to flow by year end. The support initially takes the form of a subordinated loan, to be converted to equity once we have demonstrated compliance with the related conditions. No such conversions have taken place to date as compliance with the conditions is assessed retrospectively in the quarter after receipt of the funds.

The conditions do allow Eskom to continue to draw down on existing facilities. Drawdowns from existing development finance institution (DFI) funding amounted to R3.6 billion for the period, out of a total DFI drawdown plan of R10.6 billion for the year.

At 30 September 2023, the gross book value of outstanding debt securities and borrowings stood at R442.7 billion (March 2023: R423.9 billion), including the R16 billion subordinated loan received from Government during the period. Other than that, the increase was largely due to fair value movements arising from the weakening of the Rand, which had a negative impact on the balance of foreign-denominated borrowings. We repaid interest of R18.1 billion and capital of R30.9 billion during the period from surplus operating cash flows, aided by Government's debt relief.

The debt repayment profile of existing debt only, net of swaps and based on forward rates, remains pressured over the medium term. Total interest payments of R135 billion and capital payments of R198 billion are required over the next five years to March 2028. These repayments can only be met with continued Government debt relief in the short to medium term, with a migration to cost-reflective tariffs in the longer term, supported by a continued focus on cost containment.

Credit rating agencies have acknowledged Government's commitment to providing continued support to Eskom. In May 2023, Fitch affirmed Eskom's credit rating, with a stable outlook, based on the announcement of the debt relief arrangement. Following promulgation of the Eskom Debt Relief Act in July 2023, Moody's and S&P Global upgraded Eskom's credit ratings with a stable outlook in September 2023 and November 2023 respectively. The stable outlooks reflect rating agencies' view that our creditworthiness will continue to benefit from Government's support, leading to a strengthening of our liquidity position as the balance sheet is deleveraged.

In terms of revenue outlook, we believe that NERSA's revenue decision of 18.65% and 12.74% for 2024 and 2025, while not fully addressing the lack of cost-reflective tariffs, will assist in migrating the tariff path to more appropriate levels and will greatly support our financial sustainability going forward. As reported previously, the Democratic Alliance and the South African Local Government Association have taken NERSA's decision under review. The hearing took place in September 2023, although the judgement is awaited.

In May 2023, NERSA published its reasons for decision for the regulatory clearing account (RCA) balance of R204 million in favour of the consumer for the 2021 financial year. We had applied for an RCA balance of R10.7 billion in favour of Eskom. We are reviewing NERSA's decision on a similar basis as previous RCA decisions, as it is evident that NERSA has not implemented previous court-ordered decisions when making this decision. The case was lodged in October 2023.

Regrettably, there has been no substantial progress on the other court applications under way to review NERSA's revenue and RCA determinations relating to the RCAs for the 2015 to 2018 financial years (MYPD 3), the revenue and RCA decisions for 2019 as well as the RCA decision for 2020 (MYPD 4). The legal processes for these review applications are still under way, which collectively relate to the recovery of an estimated R50 billion. However, we expect favourable outcomes as our applications adhere to the principles of the MYPD methodology. These legal processes do take time and, given the way that the regulatory process works, any amounts awarded in our favour can only be recovered through future revenue and RCA decisions from NERSA. This means that Eskom must carry the shortfall for the time being, which does have adverse implications for our liquidity.

We submitted our RCA application for the 2022 financial year in April 2023, with a balance of R23.9 billion in favour of Eskom. Based on the published timelines, NERSA is expected to announce its decision in December 2023.

Non-payment of municipal debt is a systemic challenge to the electricity industry as a whole. Eskom has pursued a multipronged strategy aimed at recovering the municipal arrear debt owed, although the problem has continued to escalate over the years. At 30 September 2023, total municipal arrear debt stood at R70 billion (March 2023: R58.5 billion). The top 20 defaulting municipalities constitute 76.7% of total invoiced municipal arrear debt (March 2023: 77.6%).

Government's municipal debt relief programme aims to support our existing municipal debt strategy and assist in addressing our arrear debt challenges over the next three years. The programme will see Eskom, in consultation with National Treasury, write off the arrear debt balance outstanding at 31 March 2023 of eligible municipalities over three financial years, subject to compliance with the programme's conditions. On a case-by-case basis, National Treasury may consider including the growth in arrear debt for certain municipalities from 1 April 2023 up to the date they are approved to join the programme. No write-offs have been processed to date as the municipalities must comply with the conditions for 12 months for Eskom to process the first third of the debt write-off. The programme is expected to improve payment levels and the settlement of current accounts by these municipalities, which will lead to an improvement in Eskom's operational cash flows over time.

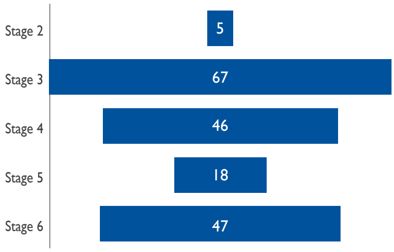
By 30 November 2023, a total of 52 municipalities have received approval or conditional approval from National Treasury for municipal debt relief. The arrear debt balance of these municipalities amounted to R50.2 billion at 31 March 2023, representing around 86% of the total municipal arrear debt balance at that date. A further 20 defaulting municipalities, accounting for R6.5 billion of the arrear debt at 31 March 2023, have applied for municipal debt relief and are awaiting approval from National Treasury.

Active partnering, where Eskom renders support to capacitate municipalities to improve collection and maintain municipal infrastructure, will further support the recovery plans for these municipalities. There are five active partnering agreements in place, with Phumelela, Msunduzi, Maluti-A-Phofung, Raymond Mhlaba and Bela-Bela municipalities. Although agreement has been reached with Maluti-A-Phofung, implementation is still pending.

OPERATIONAL PERFORMANCE

PLANT AND NETWORK PERFORMANCE

Average unplanned unavailability over the winter period (May to August 2023) was 16 513MW, higher than the Winter Plan's base case assumption of 15 000MW, resulting in loadshedding up to stage 6 on 183 days during the period (September 2022: 102 days), or 3 578 hours, which translates to an effective 149.1 days (September 2022: 1 653 hours equivalent to 68.9 days). By the end of winter, actual unplanned unavailability had exceeded the maximum assumption of the Winter Plan more than 12.7% of the time.



Incidents such as the generator explosion at Medupi Unit 4 in August 2021, the smokestack duct failure in October 2022 affecting Kusile Units 1, 2 and 3, the Kusile Unit 5 air heater fire in September 2022 delaying synchronisation and commissioning of the unit, and the Koeberg Unit 1 extended planned outage means that over 4 000MW was offline for an extended period, further adding to the constrained system and resulting in elevated levels of loadshedding being required.

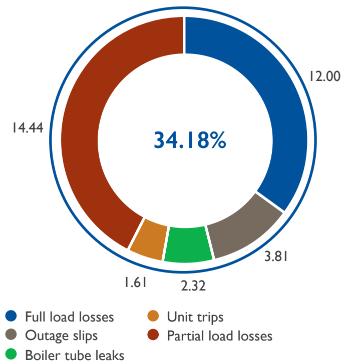
As mentioned earlier, Eskom and IPP open-cycle gas turbines (OCGTs) continued to be utilised frequently to support the power system and limit the stages of loadshedding. Eskom and IPP OCGTs generated 2.9TWh during the period (September 2022: 2.1TWh), at load factors exceeding 20%.

Plant availability (EAF) at 55.30% remains lower than the previous year (September 2022: 58.66%), and significantly worse than the shareholder compact target of 65%. The decrease in EAF compared to the previous year is largely due to an increase in unplanned losses (UCLF) to 34.18% (September 2022: 30.86%), offset by a slight decrease in other load losses (OCLF) to 0.99% (September 2022: 1.50%). Planned maintenance increased slightly to 9.53% (September 2022: 8.97%). The average energy utilisation factor (EUF) was over 90% at all 14 coal-fired stations, substantially above the expected average EUF performance of around 75% over the long term. This has negative technical implications as reflected in the increasing plant breakdowns (UCLF) resulting in declining EAF. The high EUF can be alleviated by adding additional dispatchable capacity and improving Generation plant reliability.

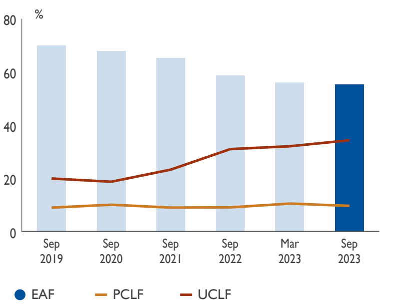
Progress on the Generation recovery plan continues and will need to be driven with increased focus. Nevertheless, average partial load losses of 6 708MW have increased significantly compared to the previous year (September 2022: 5 790MW), and remain significantly worse than target. Outage slips contributed 3.89% to overall UCLF (September 2022: 3.46%), while post-outage UCLF of 32.68% also performed worse than target (September 2022: 36.20%). During the period, only 35.29% of outages met their due date (September 2022: 52.38%), significantly below the target of 80%.

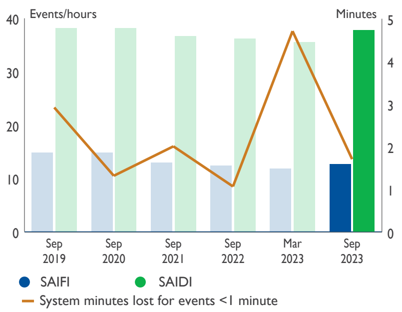
The coal fleet recorded 282 trips during the period, less than the previous year (September 2022: 395 trips). The boiler tube failure rate (failure per unit per year using a 12-month moving average) reduced to 2.01 for commercial units (September 2022: 2.41), with boiler tube failures contributing 2.48% to UCLF (September 2022: 2.98%). The boiler tube failure rate has shown an upward trend over the past five years, largely attributed to the maintenance backlog due to outage deferrals and deferred midlife-refurbishments due to constrained capital funding.

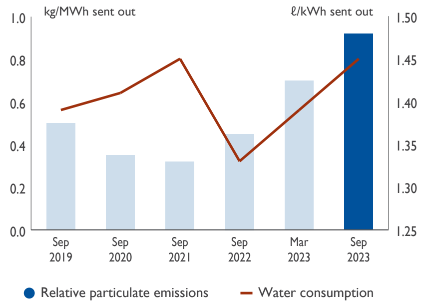
Contribution to UCLF, %



At 30 September 2023, two stations had stock below their individual minimum stockholding level (March 2023: four). Furthermore, normalised coal stock of 34 days (excluding coal stock at Medupi) has recovered above the target of 32 days (March 2023: 29 days). Coal-related load losses contributed 0.80% OCLF during the period (September 2022: 0.62%), with most losses being experienced at Matla. We continue to work with mines on initiatives to improve coal quality.







Koeberg Unit 1 was shut down on 10 December 2022 for outage 126, a planned long-duration outage which included the replacement of the three steam generators. The outage was significantly delayed due to resourcing challenges and unexpected technical challenges experienced as part of the steam generator replacement project. The unit was synchronised to the grid on 18 November 2023 and is undergoing commissioning testing at various power levels with the unit connected to the grid. Only on successful completion of all the tests, will the unit be commercially available.

Koeberg Unit 2 has remained online since the reactor trip in April 2023. The unit went off on outage on 11 December 2023 to undergo a similar long refuelling and maintenance outage to replace its three steam generators.

The long-term operation (LTO) activities to enable Koeberg to operate for another 20 years beyond 2024 continue according to schedule. The National Nuclear Regulator (NNR) has completed the first round of public engagement, with further public participation to follow, with the NNR's decision due by July 2024. The NNR requested a consolidated LTO readiness report, which we submitted in October 2023. We are also driving completion of the commitments that were stipulated in the safety case to support long-term operation. If approved, this would allow Unit 1 to operate until July 2044 and Unit 2 until November 2045.

To mitigate any delay in the regulatory process, Eskom submitted a request to the NNR to separate the licensing of each unit as part of the LTO activities. If the licence is not separated, both Unit 1 and Unit 2 will need to be shut down in July 2024. The request is to enable Unit 2's licensed end-of-life to be aligned to its 40-year life ending in November 2025. We have responded to the NNR's comments on the request, and their final decision is awaited.

As part of the licence requirements, we are working with the NNR to finalise the details of a ring-fenced nuclear decommissioning fund to ensure sufficient financial resources will be available to fund Koeberg's decommissioning costs.

Transmission system minutes performed within target at 1.71 (September 2022: 1.07), with no major incidents being recorded during the period (September 2022: one). Transmission expansion and strengthening projects have been delayed to the late placement of contracts and delays in delivery of equipment such as transformers. However, projects under the Transmission Development Plan are being prioritised to unlock 37GW of grid capacity over the next decade.

Distribution network performance remained stable and continued to perform better than target on all measures, although distribution energy losses remain outside target at 9.64% (September 2022: 9.56%).

NEW BUILD PERFORMANCE

Despite the setback suffered because of the gas air heater fire at Kusile Unit 5 in September 2022, commissioning activities continue. Repairs were completed at the end of August 2023, and the unit is expected to synchronise to the grid by December 2023, with commercial operation six months later.

At Kusile Unit 6, execution of key commissioning activities is under way, with first synchronisation forecast for August 2024, pending delivery of key outstanding boiler and turbine materials to site. Several key commissioning milestones have been successfully achieved to support first synchronisation.

At Medupi, the focus remains on completing the remaining scope on the balance of plant work, executing major plant defect repairs and resolving claims towards project close-out.

Since inception, the completed interventions to correct the major plant defects have resulted in a steady improvement in the availability and reliability of the units at Medupi and Kusile. Medupi's EAF for the period exceeded 80% (excluding the impact of Unit 4 that is offline for turbine repairs following the incident in August 2021), an improvement of around 20% since the partial correction of the major plant defects, with some units running at or near full load. The performance of Kusile Unit 4 is steadily improving.

Ultimately, the correction of the major plant defects will ensure that the plant achieves contractual levels of performance. The first phase of the partial correction of the major plant defects at Medupi and Kusile is forecast to be completed by December 2023. Additional plant defect corrections, undertaken by Eskom with or without third party involvement, is forecast for completion after 2027, depending on the extent of technical solutions and unit outage availability under the Eskom outage plan.

As part of Phase 1 of the battery energy storage systems project, construction at Hex site was completed at the end of June 2023. The site was officially opened on 9 November 2023, with commissioning imminent. Construction is under way at Pongola and Elandskop sites with construction completion planned for December 2023; commissioning is forecast for the fourth quarter of the 2024 financial year. Phase 2 of the project is on hold given the debt relief conditions and unavailability of Eskom funds from own reserves.

ENVIRONMENTAL PERFORMANCE

Relative particulate emissions performance has continued to deteriorate and is significantly worse than target, at 0.92kg/MWh sent out (September 2022: 0.45kg/MWh sent out). Kendal continues to contribute significantly to the poor performance, together with Kriel and Matla, with the stations contributing almost half of the total emitted particulate matter within Generation. By September 2023, 14 units were operating in non-compliance with average monthly emission limits, placing 8 588W at risk of being shut down by the authorities (March 2023: 13 units accounting for 7 691MW). Load losses are taken by non-performing units and where possible, poor performing units are placed on outage to undertake repairs.

Following the failure of the west chimney stack at Kusile in October 2022, the Department of Fisheries, Forestry and the Environment (DFFE) authorised Eskom in June 2023 to construct temporary stacks to operate units until the permanent stack can be constructed. The temporary stack structures were completed ahead of time, and Unit 3 was brought back to service on 30 September 2023, followed by Unit 1 on 16 October 2023, thereby alleviating pressure on the power system. Unit 2 returned to service on 28 November 2023. It is envisaged that permanent repairs to the west stack will be completed by December 2024.

The DFFE approval to Kusile Power Station for the postponement of the compliance timeframes in terms of the National Environmental: Air Quality Act, 2004, was appealed by the Centre for Environmental Rights on behalf of several organisations and neighbouring landowners. The DFFE Minister upheld the positive decision of the DFFE in September 2023, with the Nkangala District Municipality accepting the Minister's decision a few days later. The station is now able to legally operate subject to conditions which it must comply with.

Regarding the Minimum Emission Standards (MES) appeals, we continue to engage with the National Environmental Consultative and Advisory forum, appointed by the DFFE Minister to advise on the MES appeals. The forum's terms of reference were extended until August 2024. After receiving a recommendation, the DFFE minister will rule on the appeals and, where necessary, DFFE will issue revised decisions to Eskom. While the forum's work on the MES appeals is under way, stations continue to operate under the existing licence conditions.

In respect of the Kendal air quality criminal case, Eskom appeared in court on 1 November 2023, and pleaded not guilty to three of the four counts. After initial administrative discussions, the matter was adjourned until 18 to 20 March 2024, at which stage the prosecution is expected to begin presenting its case.

Water performance of 1.45ℓ/kWh sent out continued to deteriorate (September 2022: 1.33ℓ/kWh sent out). Poor water management practices due to operational challenges persist across the fleet, negatively impacting water performance. A total of 16 water-related legal contravention incidents have been registered year-to-date due to non-compliance with the National Water Act, 1998 (September 2022: 26). Focused monitoring of the effective implementation of water management action plans, both at power station level and by the Generation Environmental Compliance Steering Committee, have not yet led to a significant decrease compared to the previous financial year, although some improvement has been recorded.

The Medupi flue gas desulphurisation (FGD) project is in the development phase. In March 2023, the Board Investment and Finance Committee conditionally approved a revised strategy to pursue wet FGD. Initial funding for the project has been confirmed given the reprioritisation of internal funding. The request for proposal will be issued to the market towards the end of January 2024. The World Bank requires that the FGD pollution abatement technology be installed and has acknowledged an extension of the Medupi FGD implementation deadline to 30 September 2029. A more accurate programme will be provided to the World Bank after the contract is awarded to the selected supplier.

PEOPLE AND SAFETY

The group headcount increased slightly to 39 987 at the end of the period (September 2022: 39 871), with numbers bolstered by learner intake under the Youth Employment Services programme.

Racial equity at senior management level improved somewhat to 77.19% (September 2022: 76.95%), while racial equity at professional and management level increased to 84.37% (September 2022: 82.67%). Gender equity also improved, to 42.69% at senior management level (September 2022: 42.51%) and 41.56% at professional and middle management level (September 2022: 40.54%). Disability equity at group level has declined slightly to 2.90% (September 2022: 2.94%).

The group lost-time injury rate (including occupational diseases) deteriorated slightly to 0.28 (September 2022: 0.26). Tragically, we suffered one employee fatality during the period (September 2022: one employee and one contractor). Any life lost in Eskom's service is unacceptable and must be prevented. We offer our sincere condolences to the affected family, friends and colleagues.

Following three rounds of negotiations through the Central Bargaining Forum (CBF), Eskom and its trade unions (NUM, NUMSA and Solidarity) reached a collective agreement covering the period from July 2023 to June 2026. The agreement catered for a 7% salary adjustment per year for all bargaining unit employees and a 7% increase in the housing allowance, as well as a once-off taxable payment of R10 000 for the first two years. This is the first time in a more than a decade that all parties have reached a collective agreement during the CBF negotiation process, which is testament to the strengthening of partnerships with Eskom's trade unions.

Eskom subsequently approved a 7% adjustment in managerial remuneration costs from October 2023, of which a 4% cost-of-living adjustment was guaranteed for all managerial employees and the remaining 3% was discretionary, to retain high performers and correct income differentials.

SOCIETAL IMPACT

During the period, only procurement spend with black youth-owned suppliers achieved targeted levels. Total preferential procurement spend, as well as spend with black-owned and black women-owned suppliers, qualifying small and exempted micro enterprises, and suppliers owned by black persons living with disabilities, continued to perform below target, mainly due to expired supplier B-BBEE certificates and procurement spend related to IPP contracts that are not B-BBEE compliant. These contracts were concluded by the Department of Mineral Resources and Energy (DMRE) in terms of the renewable IPP programme. Eskom is working with DMRE to develop sector codes for IPPs, to mitigate the negative effect on procurement equity performance.

We completed 40 362 connections under DMRE's electrification programme (September 2022: 35 159). We further committed corporate social investment spend of R41.8 million during the period, assisting 174 669 beneficiaries (September 2022: R32.5 million to 282 810 beneficiaries).

READINESS FOR LEGAL SEPARATION

Eskom is implementing legal separation as set out in the *Roadmap for Eskom in a Reformed Electricity Supply Industry* issued by the Department of Public Enterprises (DPE) in October 2019, by implementing business separation and forming separate wholly owned subsidiaries to house Transmission, Distribution and Generation. Several dependencies and risks have delayed the progress against the initial timelines. These have been considered and attended to, and are at varying stages of completion.

As reported previously, the functional separation of all line divisions was completed by 31 March 2022 with reporting lines established through divisional boards. However, the timelines to meet the target for operationalisation and commencement of trade for the National Transmission Company South Africa (NTCSA) have not materialised, due to various external dependencies.

Commencement of trade by NTCSA is now targeted for April 2024, although this is still considered to be at risk, given the following dependencies:

- Lender consent has not yet been granted by all lenders, although we recently received approval from the World Bank
- Regarding the issuing of licences, following delays in the licence decisions, NERSA issued the three licences in November 2023
- NTCSA has to be designated as buyer from external sources by DMRE

- Conclusion of various governance requirements, with a key issue being the appointment by DPE of independent directors for NTCSA
- Amendment of the Electricity Regulation Act, 2006

Once all these dependencies have been met, there are also several legislative requirements under the Companies Act, 2008 that have to be complied with.

Regarding the legal separation of Distribution, DPE has conditionally approved the second application for operationalising Distribution in August 2023; Distribution continues to engage with DPE to address the conditions. Furthermore, work has commenced on the remainder of the primary activities – completion of the merger agreement, licensing and lender engagement – which are dependent on Transmission operationalisation and therefore, the Distribution timeline is sequenced accordingly. As such, the Distribution divisional board supported corporatisation of the National Electricity Distribution Company South Africa (NEDCSA) by June 2024, readiness for operationalisation in July 2025 and commencement of trade in November 2025, subject to the various dependencies.

The due diligence report for Generation has been finalised and completed. Given the approved corporate structure, the legal separation of Generation is dependent upon the establishment and operationalisation of a new holding company, in respect of which we await direction from DPE on the way forward. The revised plans target NewCo establishment in 2024/25 and legal separation of Generation in 2025. The timing of the establishment of NewCo is dependent on legislation and Government policy.

OTHER MATTERS

BOARD AND EXECUTIVE CHANGES

Several executives are acting in vacancies in key executive positions, chief among which are Mr Calib Cassim, Group Chief Financial Officer (GCFO) as acting Group Chief Executive (GCE), Mr Martin Buys as acting GCFO, Ms Natasha Sithole as acting Group Executive: Government and Regulatory Affairs and Ms Winile Madonsela as acting Group Executive: Legal and Compliance.

Recruitment processes are under way to address the vacancies and provide leadership stability. At the same time, Eskom is also finalising investigations into executives who are on precautionary suspension.

Regarding the recruitment of the GCE, the Board submitted a revised shortlist in line with the shareholder's requirements in October 2023. After careful consideration by the shareholder, Cabinet has approved the appointment of Mr Dan Marokane as GCE; he is expected to join Eskom no later than 31 March 2024.

Further to this, Mr Calib Cassim's term ends in December 2023. The Board and Mr Cassim are in discussions to renew his employment agreement, with the intention that he returns to his role as GCFO once Mr Marokane takes office. This is being done in consultation with DPE. The Board and Mr Cassim have agreed in principle on the terms, and the agreement is being finalised.

Mr Mpho Makwana stepped down as Chairman of the Board at the end of October 2023, having served one year in the position. Dr Mteto Nyati was appointed as Chairman in his stead.

PROGRESS ON GOVERNANCE CLEAN-UP

The Board remains committed to enhancing systems, controls, resources, policies and procedures as well as reporting structures to address this significant focus area. These enhancements are not yet effective as there are still areas that require significant improvement. Our compliance with the Public Finance Management Act, 1999 (PFMA) is being continuously assessed. We have identified gaps and areas where PFMA compliance has been a challenge and will continue to analyse the root causes of non-compliance to address them effectively. A detailed action plan to address the audit qualification is under development with clear objectives, timelines and responsible individuals and departments, progress on which will be monitored regularly.

Eskom has established a dedicated state capture task team, supported by external legal counsel, which has reviewed the report of the Zondo Commission and developed an implementation plan to address the recommendations of the Commission. The implementation plan has been submitted to the shareholder, together with periodic updates. The task team has undertaken several steps within Eskom's control to implement the recommendations, the highlight being disciplinary processes undertaken against delinquent suppliers. Based on the task team's assessment and recommendations, 32 delinquent suppliers have been removed from Eskom's supplier data base for periods ranging from one to 10 years, with recommendations to be made to National Treasury for their removal from the central supplier database. Suspended sanctions have been implemented against 30 suppliers.

Furthermore, an independent legal firm has been appointed to assist the Board in addressing matters arising from allegations made in the Fivaz report and determining any further steps required. The firm has obtained a copy of the report and is consolidating the findings to aid in the Board's investigation.

An assessment of Eskom's crime risk management landscape, in partnership with an independent service provider, is in progress. This initiative is aimed at identifying risks related to bribery and corruption, financial crime, physical asset crime, cyber-crime and money laundering. We are also in the process of appointing a service provider to assist with artificial intelligence analysis to identify further transactions to be investigated.

OUTLOOK

Eskom's financial performance in the first half of the year tends to be better than the second half, with the winter period typically characterised by higher tariffs and sales volumes than the summer period. In addition, less maintenance is performed in winter to ensure adequate supply to sustain the increased demand and to offset lower winter production by renewable IPPs. Given this seasonality, there is considerable cost pressure in the second half of the financial year, driven by higher summer maintenance requirements and costs associated with ensuring security of supply such as the use of expensive OCGTs.

Despite achieving a profit in the first six months, by the end of the year we expect to record an after-tax loss of R23.2 billion, as poor generating plant performance, the lack of cost-reflective tariffs, high debt service costs and non-payment by some customers continue to contribute to the loss-making position in the short term.

As we have said before, Government's debt relief solution will go a long way towards improving financial sustainability and liquidity in the short to medium term, the impact of which we have already seen in the recent ratings upgrades. We are focused on ensuring compliance with the conditions to ensure that the support, which will initially come in the form of a subordinated loan subject to market interest rates, is converted to equity, to realise the full benefit thereof. Coupled with this, we need to execute our turnaround plan to improve financial and operational performance in the medium to long term.

Sales of 185.3TWh are expected by year end, which is 3.1TWh or 1.6% lower than the previous financial year due to continued supply constraints. Primary energy costs are expected to increase by about 15% year-on-year, due to increased production from OCGTs, IPPs and inflationary increases. The average coal purchase price per ton is expected to increase by 15.8% year-on-year due to double-digit growth in costs in the mining sector and an increase in more expensive short- and medium-term coal contracts to recover coal stock days at various sites.

We are managing Eskom-owned OCGT costs within the budget of R19.7 billion, with higher production being offset by a lower price due to favourable diesel price movements. However, if system performance were to deteriorate further or fuel prices increase beyond budget assumptions, an increase in the OCGT budget may be required to ensure adequate fuel supply is available to maintain grid stability. Any increase will be funded from cash from operations, including through cost savings in other areas.

As mentioned, the Standard Offer Programme, Emergency Generation Programme and RMIPPPP – intended to provide additional capacity and offset usage of expensive OCGTs – have unfortunately been delayed. IPP OCGTs are expected to operate at a load factor of almost 24% against a budget of around 12%, to augment supply due to delays in other IPP programmes, by reallocating the unutilised budget from these programmes.

Altogether, the forecast indicates that we will spend around R32.2 billion on our own and IPP-owned OCGTs to the end of the financial year. The situation is expected to continue until such time as plant reliability improves, the country's generation capacity increases and the shortage is alleviated.

Therefore, our overall focus remains on improving the performance of the Generation fleet, to reduce the level of loadshedding being experienced by the country and to limit the amount spent on supplementing supply through expensive diesel plant. We are targeting to reach an EAF level of 65% by March 2024, assisted by the return to service of three units at Kusile discussed earlier. However, the return to service of Koeberg Unit 1 was followed by Unit 2 going off on extended outage on 11 December 2023, with no immediate net benefit to the system. Although adding to the system constraints in the short term, these extended outages will enable Koeberg to operate reliably for an additional 20 years, subject to the NNR extending the licence, which will benefit the system in the long term.

The imminent synchronisation to the grid of Kusile Unit 5 will further assist the grid, even though the unit will not be operating at full power until commercial operation in mid-2024. As indicated, Kusile Unit 6 is planned to be synchronised to the grid in the second half of the 2024 calendar year, at around the same time as the expected return to service of Medupi Unit 4 using a second-hand stator.

Even with these improvements, we still require about 4 000MW–6 000MW of base-load capacity on the grid, to ease supply constraints and stabilise the grid, creating the space for much-needed maintenance of our generating plant.

In pursuit of legal separation, we continue with bilateral engagements with lenders regarding the legal separation process and associated timelines. The transfer of the Transmission Division to NTCSA is subject to certain suspensive conditions being met, including obtaining applicable lender consent.

We remain committed to South Africa's Just Energy Transition in the long term to decrease greenhouse gas emissions, promote job creation through reskilling, and stimulate economic growth, thereby focusing on long-term growth and sustainability. We are reviewing our 2035 station shutdown plan, given the prevailing system constraints, to ensure the optimised shutdown of stations that are approaching their end of economic life, while mitigating the associated socio-economic impacts on affected communities. We are also exploring opportunities for public-private partnerships to fund JET initiatives, with the support of National Treasury. Under the conditions of the Eskom Debt Relief Act, 2023, greenfield generation projects may be pursued with written approval from the Minister of Finance.

Despite the many challenges facing us, we simply must place Eskom on a more sustainable footing through our turnaround plan, for which we require the support of all our stakeholders. Ultimately, this requires resolving Eskom's capital and tariff structures, delivering on our operational recovery to improve the performance of our plant and alleviate the constrained power system, and bringing much-needed structural reforms to the electricity industry.

FORWARD-LOOKING STATEMENTS

Certain statements in this commentary regarding Eskom's business operations may constitute forward-looking statements. These include all statements other than statements of historical fact, including those regarding the financial position, business strategy, management plans and objectives for future operations.

Forward-looking statements constitute current expectations based on reasonable assumptions, data or methods that may be imprecise and/or incorrect and that may be incapable of being realised. As such, they are not intended to be a guarantee of future results. Actual results could differ materially from those projected in any forward-looking statements due to various events, risks, uncertainties and other factors. Eskom neither intends nor assumes any obligation to update or revise any forward-looking statements contained in this commentary, whether as a result of new information, future events or otherwise.