Eskom

# 7th National Treasury of South Africa/OECD Forum on African

## ECA Finance – A key driver of infrastructure development

Andre Pillay
Funding Execution, Treasury

28 June 2013

Powering your world 1923-2013

# Disclaimer

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 the Group Capital division at investment levels and rates of return consistent with prior experience, as well as achievements of planned productivity improvements throughout the business activities.

Actual results could differ materially from those projected in any 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 certain publicly available data was used. While the sources used are generally regarded as reliable the content has not been verified. Eskom does not accept any responsibility for using any such information.

# Agenda

**Eskom at a glance**

**Finance**

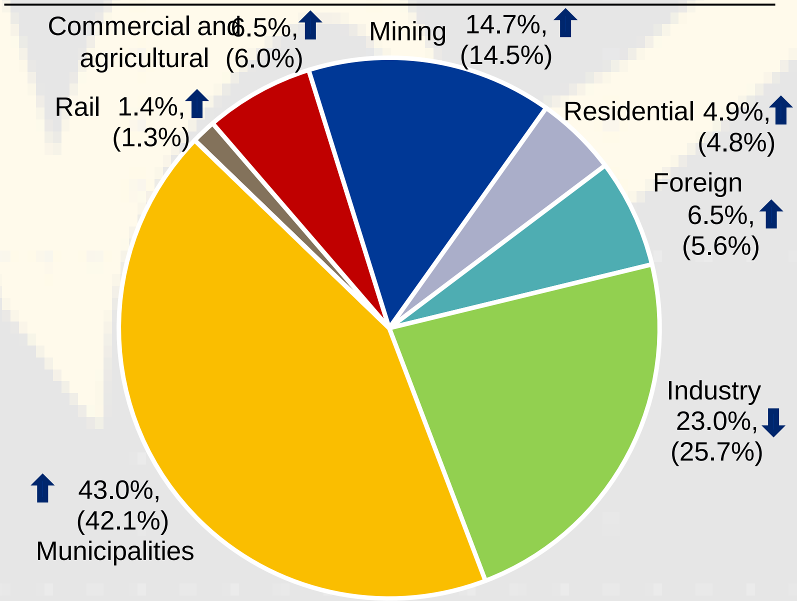
**Funding – ECA**

# Eskom at a glance

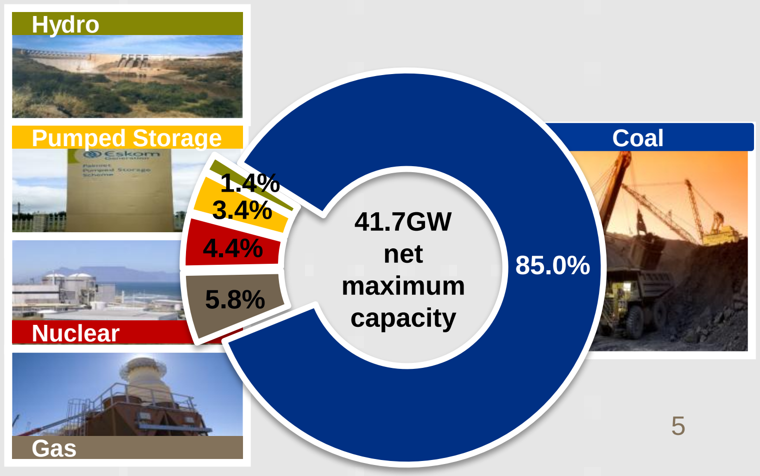
# Eskom at a glance

- Strategic 100% state-owned electricity utility, strongly supported by the government
- Supplies approximately 95% of South Africa's electricity and more than 40% of Africa's electricity
- For the six months ended 30 September 2012:
  - Electricity sales of 110 766GWh (2011: 114 043GWh) and electricity revenues of R71.9bn (2011: R63.1bn)
- As at 30 September 2012:
  - 44 913 group employees (September 2011: 41 756)
  - 4.9 million customers (September 2011: 4.7 million)
  - Net maximum generating capacity of 41.7GW (September 2011: 41.3GW)
  - 372 031km of cables and power lines
  - Moody's and S&P ratings: Baa3 and BBB respectively with a negative outlook
  - 17.1GW of new generation capacity by 30 September 2018, of which 5.8GW already commissioned

**Eskom electricity sales by customer for the six months ended 30 September 2012 (2011)**




**Generation capacity– 30 September 2012**



# Executive summary

- Safety
  - Safety improved, but continues to be of primary focus
- Power system
  - No load shedding since April 2008, despite an extremely tightly balanced power system
  - Severe winter weather impacts the supply to customers in some provinces, but Eskom's preparedness helps to mitigate the risk
- Capacity expansion programme
  - Significant progress made. Medupi on track to deliver first power in 2013
- Business results
  - Interim results reflect the impact of declining demand for electricity, due to lower economic growth and industrial unrest
  - More will be spent on maintaining our power stations to improve reliability in the second half of the year
  - Full-year profit will be lower than the six months profit
  - Profits are reinvested in full in Eskom's business, helping to fund the capacity expansion programme and to service debt
- Funding
  - Secured 79.5% of the funding required for the capacity expansion programme
  - Downgrades by credit rating agencies highlight the need for Eskom to be financially sustainable
  - MYPD 3 application submitted to NERSA in October 2012

# Finance

# Income statement for the six months ended 30 September 2012

- Group revenue of R73.4 billion (30 September 2011: R64.0 billion), an increase of 14.7%
- Electricity sales of 110 766GWh for the half-year ended 30 September 2012 (30 September 2011: 114 043GWh)
- Electricity sales are subject to seasonal fluctuations
- Primary energy costs of R25.0 billion (30 September 2011: R21.9 billion), an increase of 14.3%
- Opex costs of R26.9 billion (30 September 2011: R21.7 billion), an increase of 24.1%
- Effective tax rate of 28.5% (30 September 2011: 28.6%)
- Net profit of R12.6 billion as at 30 September 2012 (30 September 2011: R12.8 billion). This profit is expected to decrease by year end, due to the seasonal nature of the business

| Rm | Reviewed 6 months to 30 Sep 2012 | Reviewed 6 months to 30 Sep 2011 | Reviewed 6 months to 30 Sep 2010 | Audited year to 31 Mar 2012 |
|---|---|---|---|---|
| Revenue | 73 368 | 63 993 | 51 114 | 114 847 |
| Other income | 516 | 396 | 351 | 712 |
| Primary energy | (24 973) | (21 858) | (17 199) | (46 314) |
| Opex (1) | (26 881) | (21 659) | (16 400) | (44 872) |
| Net fair value loss on financial instruments | (1 292) | (1 126) | (625) | (2 388) |
| **Operating profit before embedded derivatives** | **20 738** | **19 746** | **17 241** | **21 985** |
| Embedded derivative gain / (loss) | 698 | 263 | (1 471) | 334 |
| **Operating profit** | **21 436** | **20 009** | **15 770** | **22 319** |
| *Gross finance costs* | *(17 699)*[2] | *(6 958)* | *(5 351)* | *(8 955)*[2] |
| *Finance costs capitalised* | *13 914* | *4 855* | *2 985* | *4 999* |
| Net finance costs | (3 785) | (2 103) | (2 366) | (3 956) |
| Other | 22 | 16 | 8 | 41 |
| **Profit before tax** | **17 673** | **17 922** | **13 412** | **18 404** |
| Income tax | (5 044) | (5 129) | (3 879) | (5 156) |
| **Net profit for the period** | **12 629** | **12 793** | **9 533** | **13 248** |

(1) Opex including depreciation and amortisation

(2) Includes the effect of the remeasurement of the government loan: R9.6 billion cost for the six months to 30 September 2012 (R5.5 billion gain for the year to 31 March 2012)

# Key performance ratios

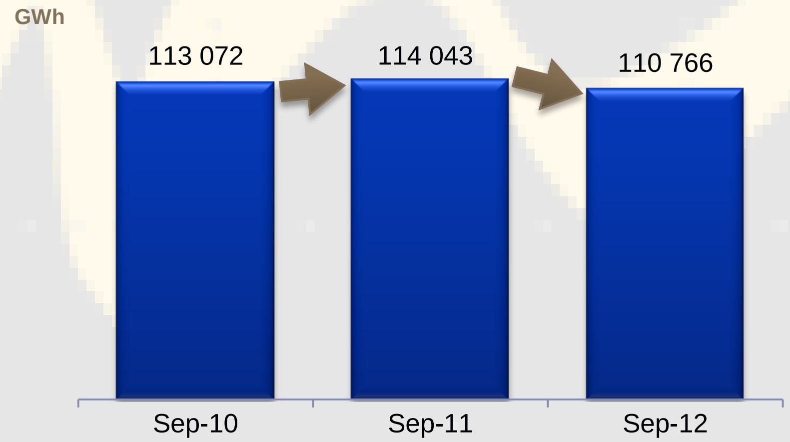
| | Unit | Reviewed six months ended 30 Sep 2012 | Reviewed six months ended 30 Sep 2011 | Reviewed six months ended 30 Sep 2010 |
|---|---|---|---|---|
| EBITDA | Rm | 26 158 | 24 098 | 19 188 |
| Funds from operations (FFO) | Rm | 22 257 | 22 755 | 14 635 |
| Gross debt/ EBITDA | ratio | 9.1 | 8.3 | 7.5 |
| FFO/ gross debt | % | 9.4 | 11.4 | 10.1 |
| Return on average total assets (1) | % | 3.1 | 3.7 | 3.6 |
| Return on average equity (1) | % | 11.5 | 13.4 | 12.4 |
| Working capital ratio | ratio | 1.0 | 1.0 | 1.1 |
| Revenue per kWh (electricity sales) | cents per kWh | 64.9 | 55.3 | 44.6 |
| Costs per kWh (electricity business) | cents per kWh | 47.0 | 38.2 | 30.6 |
| Bad debt as percentage of revenue | % | 0.7 | 0.9 | 0.8 |
| *Average debtor days:* | | | | |
| Customer service large power users | days | 21.5 | 21.0 | 20.3 |
| Customer service small power users(2) | days | 41.3 | 40.5 | 40.0 |
| Customer service, Top Customers | days | 14.0 | 14.7 | 16.2 |

(1) Historic
(2) Excluding Soweto debt
(3) Excluding disputes

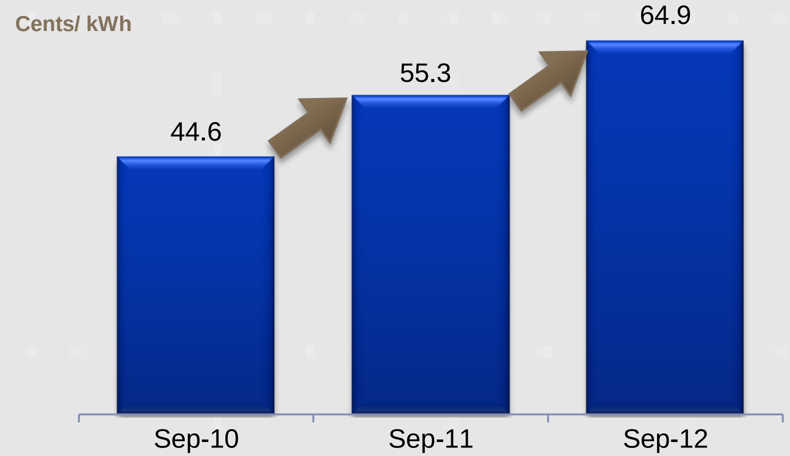
# Sales and revenue

- 110 766GWh sales for the half year to 30 September 2012 represents:
  - a 2.9% decrease compared to last year;
  - below the budgeted sales of 112 008GWh (budgeted contraction of 1.8%)
- Sales contracted (in GWh) due to:
  - Industrial action in the mining sector
  - Processing problems experienced at a major customer
  - The impact of power buybacks during the first quarter of the financial year
  - Poor market conditions
- Lower growth rate projected to continue; year-end projected sales have been adjusted down to 219 342GWh from the budgeted 222 083GWh
- Revenue per kWh increased by 17.3% compared to the same period last year primarily as a result of the 16.0% tariff increase granted by NERSA

## Electricity sales (GWh)

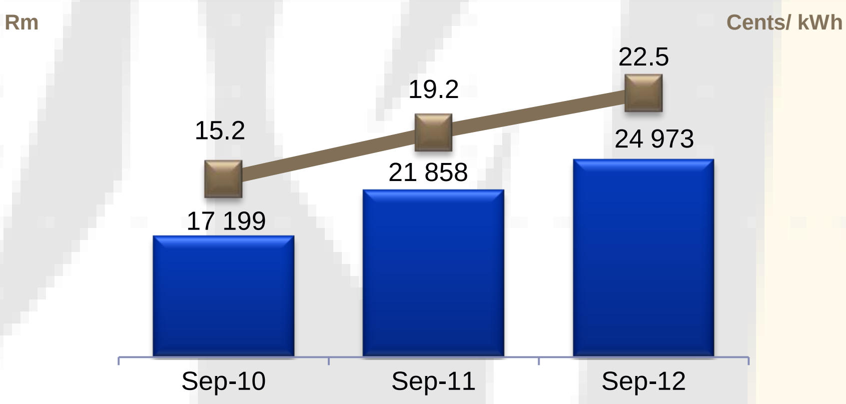



## Electricity revenue (c/kWh)

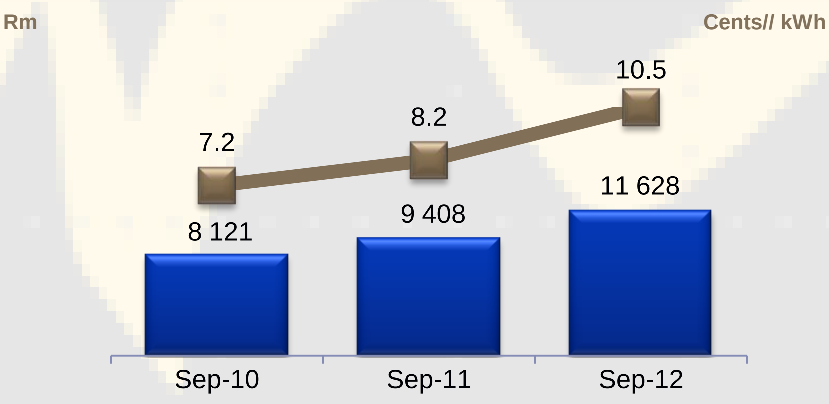


# Operating expenses[1]

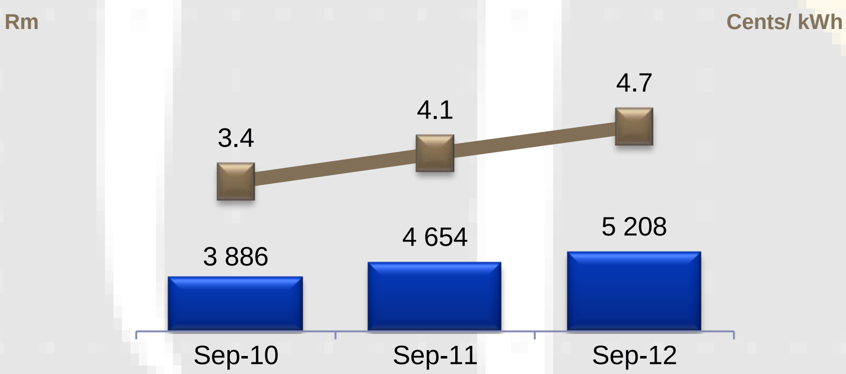
## Primary Energy Costs



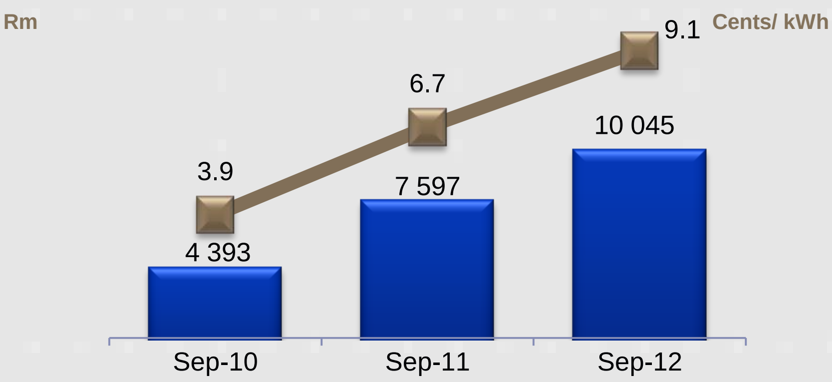

## Employee Benefit Expenses




## Depreciation & Amortisation Expenses[2]



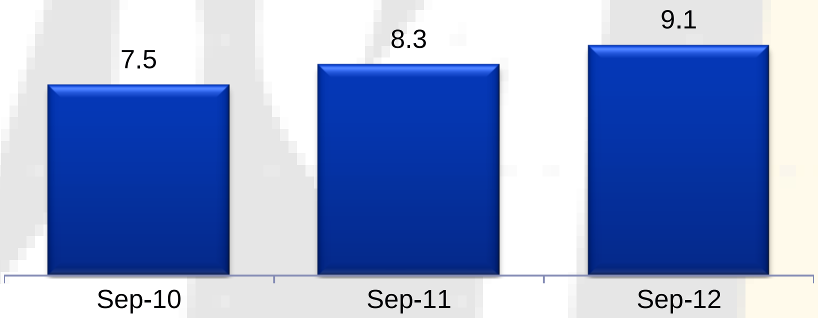

## Other Operating Expenses[3]



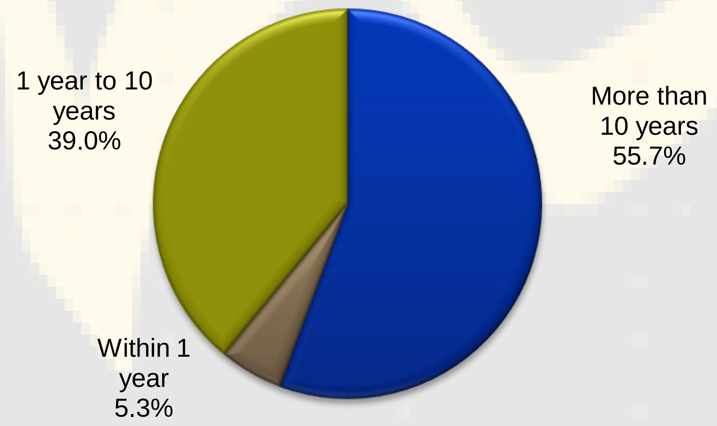

(1) Cents/kWh figures are calculated based on total electricity sales numbers
(2) Including net impairment loss
(3) Including managerial, technical and other fees, R&D, operating lease expense, auditor's remuneration, repairs and maintenance

# Debt maturity and leverage

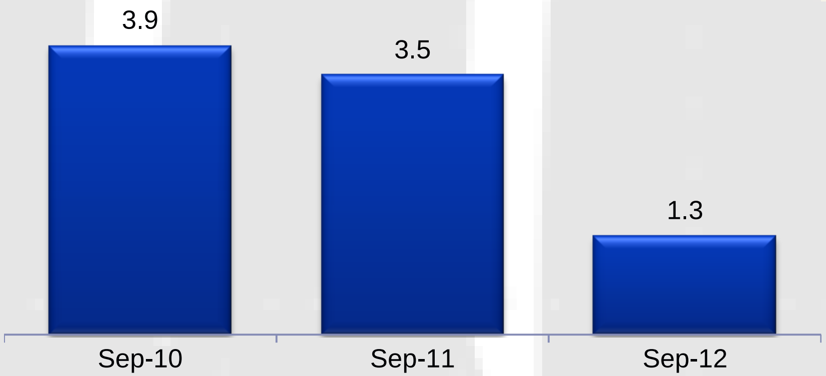
## Gross Debt/EBITDA ratio



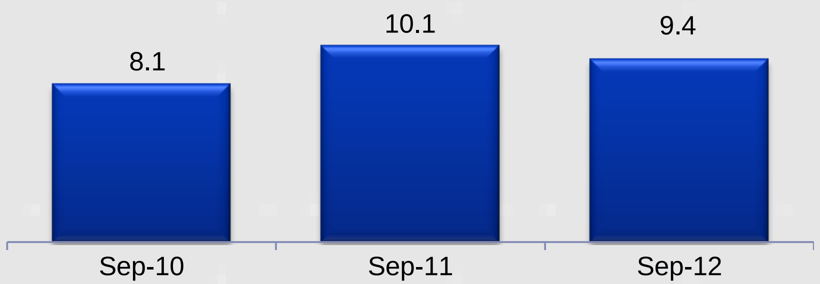

## Debt & Borrowings Maturity Profile(1)




## Interest Cover ratio

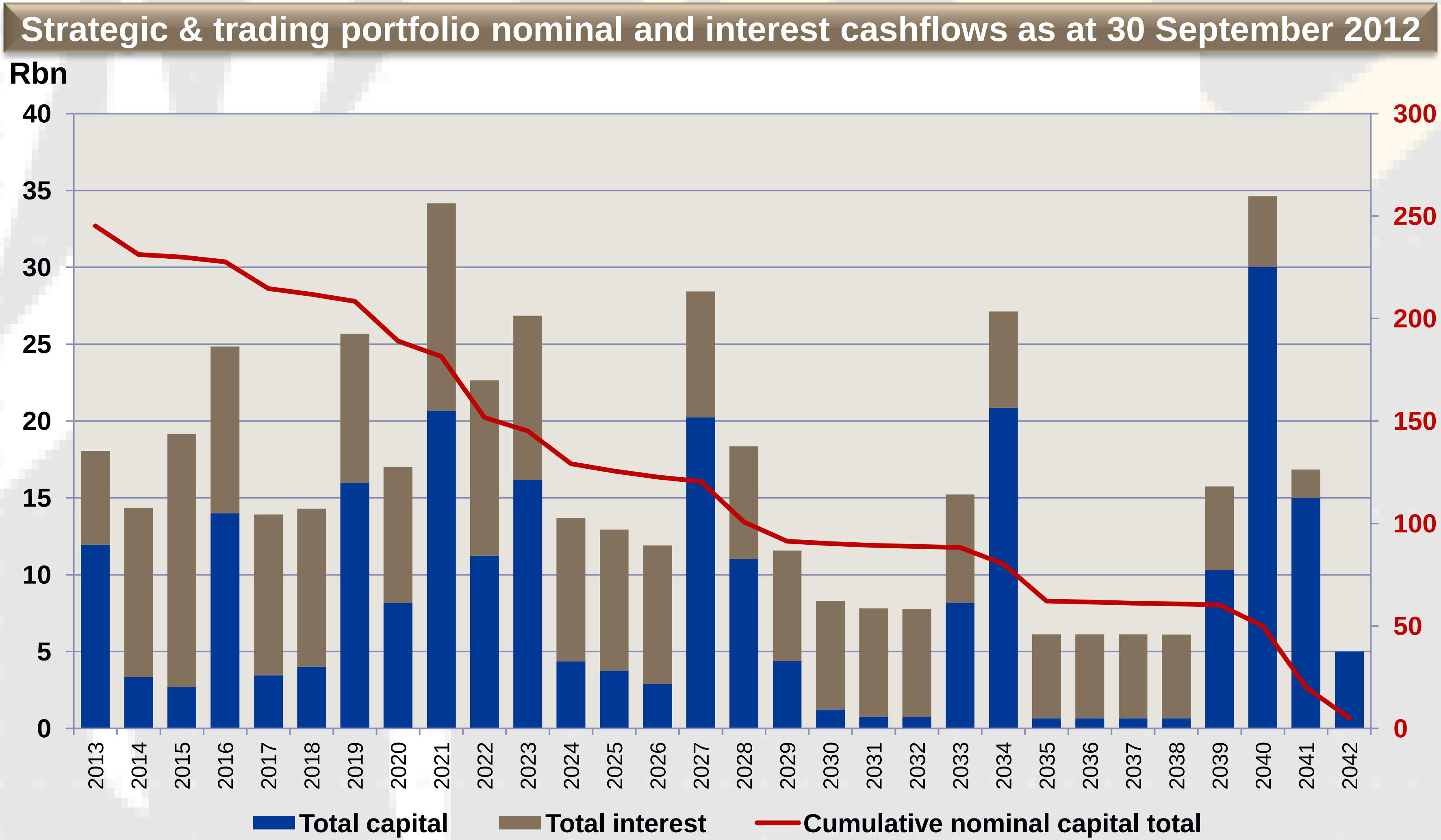



## FFO as a % of Gross Debt




(1) Represents the repayment of nominal capital in the strategic and trading portfolio. Data as at 30 September 2012

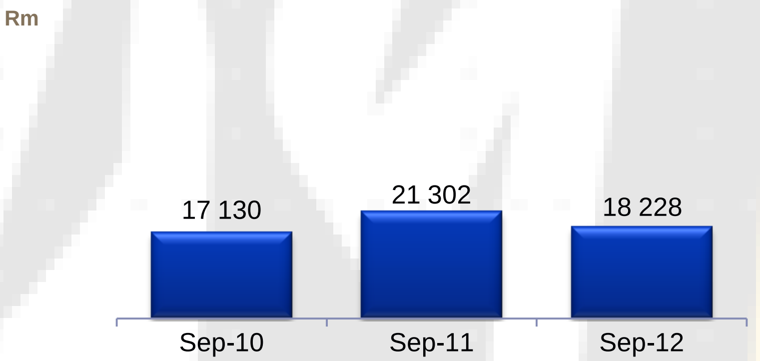
# Debt maturity profile as at 30 September 2012



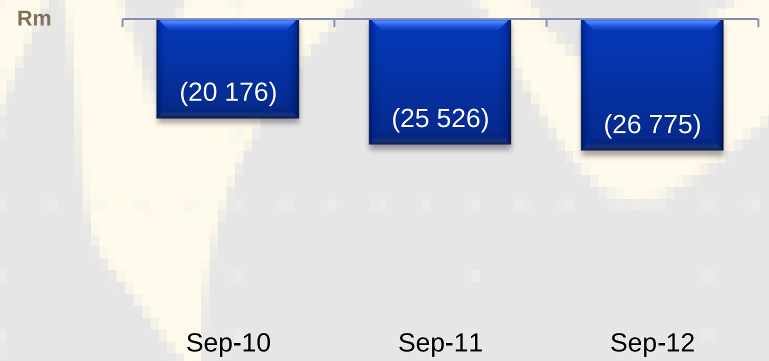

The weighted average cost of borrowing as at 30 September 2012 was 9.03% excluding the remeasurement of the government loan (September 2011: 9.84%)

# Group reviewed cash flows[1]

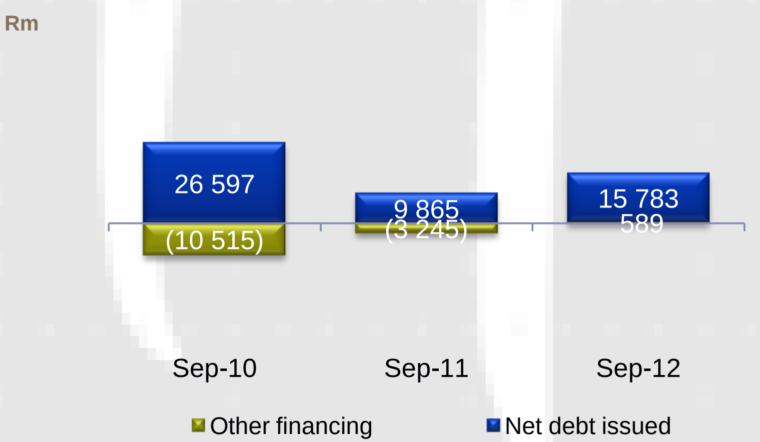
## Cash flows from operating activities



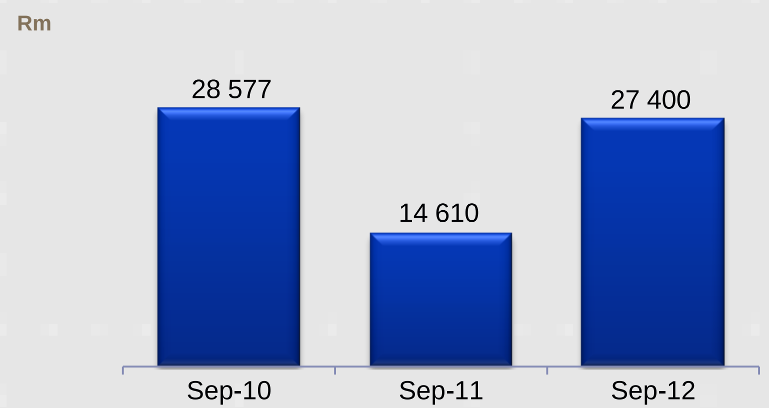

## Cash flows utilised in investing activities




## Cash flows from financing activities

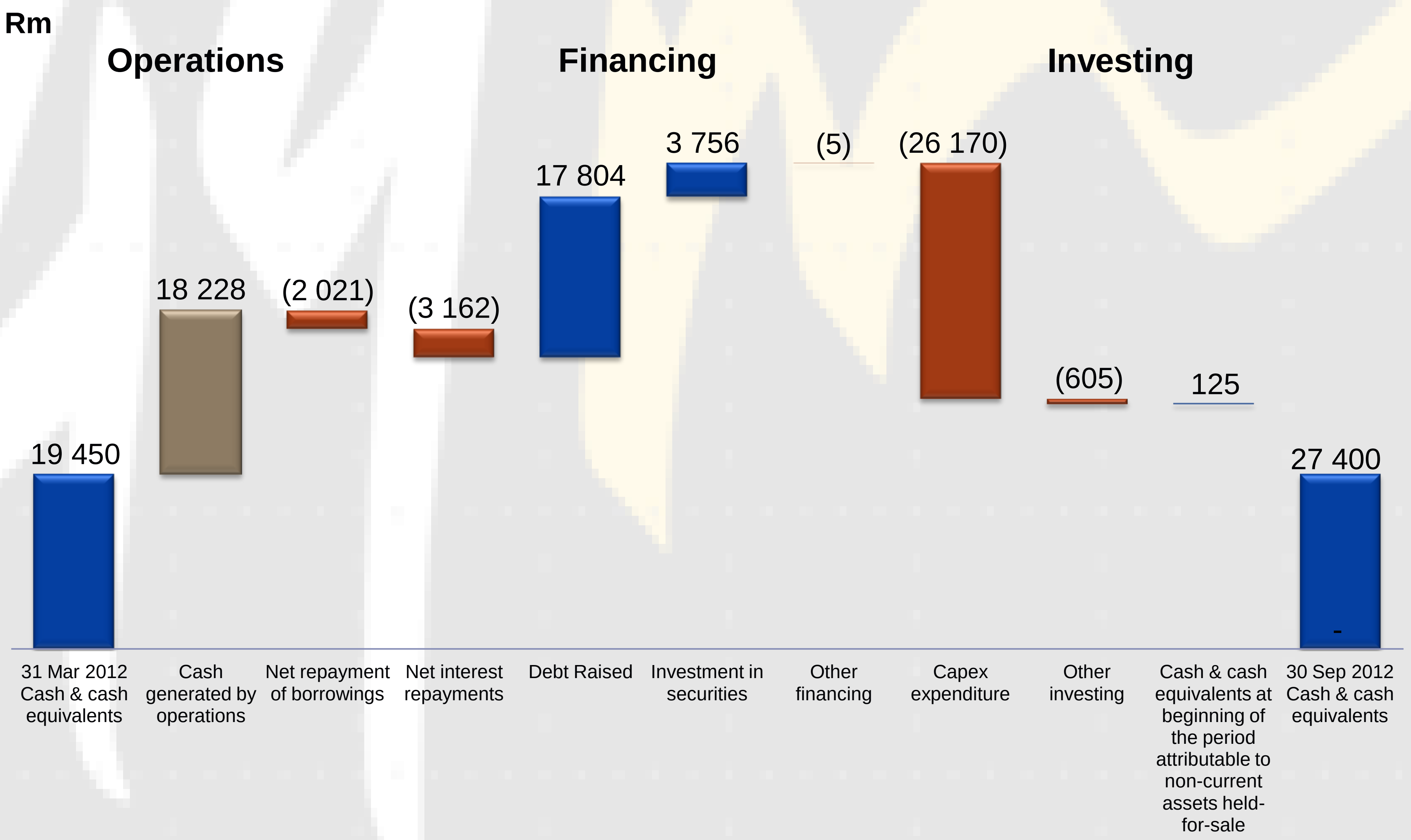



## Cash and cash equivalents at period end




1) Cash flows for 2011 have been restated - R127m cash and cash equivalents resulting from common control transaction adjusted on the 30 September 2011 cash flow statement

# Summary of reviewed cash flows



# Credit ratings

| Entity | Rating Status | Moody's | S&P | Fitch |
|---|---|---|---|---|
| Eskom Holdings SOC Ltd | Foreign Currency | Baa3 | BBB | - |
| | Local Currency | Baa3 | BBB | BBB+ |
| | ZAR Long-term | - | AA | AA+ |
| | ZAR Short-term | - | A-1 | F1+ |
| | Outlook | Negative (1) | Negative (3) | Stable(4) |
| Stand-Alone Ratings | | Ba3 | B | None |
| RSA Govt. | Foreign Currency | Baa1 | BBB | BBB |
| | Local Currency | Baa1 | A- | BBB+ |
| | ZAR Long-term | - | AAA | AA+ |
| | ZAR Short-term | - | A-1 | F1+ |
| | Outlook | Negative (2) | Negative (3) | Stable(4) |

(1) Moody's downgraded Eskom's credit rating from Baa2 to Baa3 (negative outlook) on 1 October 2012

(2) Moody's downgraded South Africa's sovereign credit rating from A3 to Baa1 (negative outlook) on 27 September 2012

(3) On 12 October 2012 Standard & Poor's lowered the long term foreign and local currency ratings on the Republic of South Africa to BBB (from BBB+) and A- (from A+), respectively. In accordance with its criteria for government-related entities, Standard & Poor's has therefore lowered Eskom's long-term foreign and local currency credit ratings from BBB+ to BBB on 17 October 2012. It has also retained its negative outlook on Eskom as with the sovereign

(4) On 10 January 2013, Fitch announced the following rating actions on the Sovereign; (i) downgrade of the long-term foreign currency Issuer Default Rating ("IDR") to 'BBB' from 'BBB+'; (ii) downgrade of the long-term local currency IDR to 'BBB+' from 'A'; (iii) downgrade of the Short-term IDR to 'F3' from 'F2'; downgrade of the Country Ceiling to 'A-' from 'A'; and (iv) outlook review from 'Negative 'to 'Stable. On 11 January 2013, Fitch downgraded Eskom's local currency rating by one notch to BBB+, following the downgrade of South Africa's sovereign rating. Fitch has, however, revised its outlook on Eskom from 'negative' to 'stable'. The sovereign downgrade also prompted a recalibration of the South African National Scale which resulted in the downgrade of Eskom's Long-term National Scale Rating to 'AA+/Stable' from 'AAA/Stable' on 16 January 2013. The Short-term 'F1+/Stable' has been affirmed.

# Current credit rating uplifts

| | Moody's Investors Service | Standard & Poor's | FitchRatings |
|---|---|---|---|
| | Long-term | Long-term | Long-term local currency |
| Investment grade | Aaa | AAA | AAA |
| | Aa1 | AA+ | AA+ |
| | Aa2 | AA | AA |
| | Aa3 | AA- | AA- |
| | A1 | A+ | A+ |
| | A2 | A | A |
| | A3 | A- | A- |
| | Baa1 | BBB+ | BBB+ (Final rating) Eskom |
| | Baa2 | BBB (Final rating) Eskom | BBB |
| | Baa3 (Final rating) Eskom | BBB- | BBB- |
| Non-investment grade | Ba1 | BB+ | BB+ |
| | Ba2 | BB | BB |
| | Ba3 (Standalone) Eskom | BB- | BB- |
| | B1 | B+ | B+ |
| | B2 | B (Standalone) Eskom | B |
| | B3 | B- | B- |
| | Caa1 | CCC+ | CCC+ |
| | Caa2 | CCC | CCC |
| | Caa3 | CCC- | CCC- |
| | Ca | | |

+3 notches

+6 notches

# Funding – ECA

# Funding plan – R300 billion from 1 April 2010 to 2017

| Source of funds | Funding sourced Rbn | Currently secured Rbn | Draw-downs to date Rbn | Amount supported by Government Rbn |
|---|---|---|---|---|
| Bonds | 90.0 | 38.1 | 38.1 | 25.6 |
| Commercial paper | 70.0 | 70.0 | 25.0 | 0.0 |
| Export Credit Agency backed | 32.9 | 32.9 | 17.5 | 0.0 |
| World Bank loan | 27.8 | 27.8 | 7.5 | 27.8 |
| AFDB loan | 20.9 | 20.9 | 12.6 | 20.9 |
| DBSA loan | 15.0 | 15.0 | 4.0 | 0.0 |
| Shareholder loan | 20.0 | 20.0 | 20.0 | 20.0 |
| Other sources | 23.4 | 13.9 | 0.9 | 4.9 |
| **Totals** | **300.0** | **238.5** | **125.5** | **99.1** |
| | | | | |
| Percentages | | 79.5%(1) | 52.6%(2) | 41.6%(2) |

(1) As a percentage of the R300bn funding sourced
(2) As a percentage of the currently secured total

# Progress in the past 6 years

**Broader lender base**

- To date 19 banks have participated in 12 ECA transactions

**Longer tenors**

- Banks and ECAs have been accommodative in aligning the funding and ECA cover with the generally lengthy construction period of Eskom projects.

**Access to greater variety of ECAs**

- Although concentrated in Europe, the geographical spread of Eskom suppliers has allowed for financing of various contracts with 5 different ECAs, 2 of which are non-European
- Increased visibility and interest amongst ECAs with which Eskom had no prior business dealings.

**Established covenants and terms and conditions**

- Banks and ECAs alike well-acquainted with Eskom's position on key covenants and issues
- Facilitates smoother, more focused negotiations
- Reduced execution risk

# Market dynamics (borrower perspective)

**In the earlier years (pre global financial crisis)…**

- Excessive appetite (greater balance sheet commitment)
- Pricing competition among the banks active in the ECA market
- Growing interest in local currency financing

**The latter years (during and post global financial crisis)…**

- Significant increase in liquidity costs (especially Eurozone banking community)
- Greater weight placed on borrower rating (credit rating and OECD country rating)
- The quality of the ECA cover/credit enhancement negatively impacted appetite and pricing in the light of several sovereign credit rating downgrades
- Impact of downgrades caused some banks to retreat altogether from certain jurisdictions
- Basel III requirements forced banks to deleverage (“selling down” their exposures)
- Syndicated structures preferred over large ticket sizes (more parties at negotiating table)

# Advantages and disadvantages

**Advantages**

- Long tenor funding allowing for better asset-liability management
- Increasing scope for local currency financing
- Reliable source of funding with most banks maintaining appetite despite increased capital costs

**Disadvantages**

- Other financing sources (e.g. DFIs) proving to be more cost effective for the same and even longer tenors
- Local currency financing even more expensive given the limited ZAR funding capabilities of foreign banks and higher ECA premiums attached to it
- Differing local content financing between ECAs may conflict with localisation objectives of SOCs
- No uniform position by all ECAs on key points (e.g. local currency, eligible local content, extent of "claw back" periods for retrospective financing, date of applicable CIRR etc.)
- The borrower does not realise any benefit, insofar as the ECA premium is concerned, from the improvement in its financial condition as the transaction progresses

# Thank you