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BUDGET 2023 AND ESKOM'S DEBT RELIEF PLAN – WHAT WE WOULD LIKE TO SEE

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"Insanity is doing the same thing over and over and expecting a different result."
Albert Einstein

By Eskom's own admission in their FY22 results presentation[1], their return to standalone financial sustainability is reliant on four challenges being addressed:

1. Cost-reflective tariffs;
2. Improved cost efficiencies, particularly addressing the excessive use of Open-Cycle Gas Turbines (OCGTs);
3. Addressing municipal debt arrears; **and**
4. A debt relief solution.

It is important to state up front that the above items **ALL** need to be addressed in order to return Eskom to standalone financial sustainability.

Given the long-overdue clarity on item #4 in the list above (i.e. the proposed Eskom debt relief solution), and the hope that this will be provided in Wednesday's upcoming Budget Speech, we focus on this aspect in this note.

What do we want to see in Minister Godongwana's upcoming Budget Speech as regards Eskom's proposed debt relief solution? This can be distilled into six key requirements:

1. The shareholder needs to commit to implementing the debt relief solution in such a way that all creditors are treated fairly and in line with our existing rights and obligations, i.e. that no one set of creditors is advantaged (or prejudiced) over another. Given the complexity of Eskom's debt (which is a combination of local/foreign, guaranteed/unguaranteed, capital markets/bi-lateral) with a myriad of loan terms, maturities and conditions, this is not an easy task but is the cornerstone for any proposal to be acceptable to Eskom's funders, the rating agencies and the market in general.
2. It is important that the debt solution does not trigger any of the ratings agencies or loan agreements' definitions of a default or a debt restructure.

[1] Slide 19, "Eskom_2022 results presentation_web.pdf" available on Eskom's website

3. The amount that is removed from Eskom's balance sheet must be meaningful. Eskom itself is expecting that it will "address one-third to two-thirds of Eskom's debt[2]". This could mean that up to R280 billion could be taken over (Eskom's borrowings are reported to be in excess of R420 billion[3] as at 31 December 2022). To assess whether this is meaningful requires asking a further question: "what level of interest (and by implication, level of debt) is sustainable, given Eskom's current cashflows and operating environment?" A crude calculation shows us that if half of Eskom's debt disappears, this should result in an immediate halving of Eskom's net finance cost (from R33 billion to R16.5 billion). On Eskom's FY23 forecast EBIT of R11.3 billion, this still leaves a R5 billion negative gap. This underscores the harsh reality that, while removing up to R200 billion of Eskom's debt is indeed a meaningful number, Eskom's return to financial sustainability will require more than just this one intervention.

4. Any conditionality attached to the debt solution needs to be clearly communicated and transparently managed. We need to understand i) the conditions; ii) who is responsible for delivering them; iii) the timeframes they will apply to; iv) whether they are realistic/achievable; and v) the consequences for non-compliance. We will need regular updates as to the status of any conditions that are imposed. If the conditions are not met (or are unrealistic or unachievable), we also need to understand what the shareholder's plan B will be – i.e. if Eskom is not relieved of some of its unsustainable debt due to not meeting the required conditions, what other actions will government, as Eskom's 100% shareholder, take to ensure Eskom's swift return to financial and operational sustainability?

5. Linked to points 3 and 4 above is the timing of the solution, specifically whether the relief is immediate (i.e. the full amount of say R200 billion is immediately taken over by national government) or whether this is staggered and say R50 billion per annum is taken over in each of the next four years. There are pros and cons to each option, and we need to understand the trade-offs and other decisions that will be required, depending on which choice the government makes. Upfront relief of the full amount provides the almost immediate benefit of releasing cashflow currently spent on interest - the full effects of which will start to be felt from this upcoming FY24 financial year. The downside to a large upfront amount is that conditions become difficult to impose after the debt has been removed. Whereas staggering the relief allows for better management of any conditions (the next amount will not be taken over if the conditions are not met), it also has the drawback of not providing immediate meaningful cashflow relief for Eskom, which may lead to Eskom's financial unsustainability remaining a reality for the foreseeable future.

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[2] Slide 19, "Eskom_2022 results presentation_web.pdf" available on Eskom's website
[3] https://www.moneyweb.co.za/news/economy/all-eyes-on-godongwana-as-eskom-debt-grows-to-r422 billion/

6. We need to understand Eskom's funding plan following implementation of the solution, including its capex, opex and maintenance funding plan, as well as how any ongoing cashflow "holes" will be funded. This is where the responses to the other three challenges become key: if tariffs are not appropriately cost-reflective; if significant cost efficiencies are not achieved; and if the arrear municipal debt problem is continued to be allowed to balloon, then Eskom will find itself in the untenable position of needing to raise further debt to fund itself - with the end result that it ends up with an unsustainable (and over-geared) balance sheet again in a few years' time. Government has already, since 2009, injected over R240 billion[4] to Eskom with an additional R66 billion allocated for FY24-FY26. If we exclude the quantum of support that this proposed debt relief solution will provide, the shareholder will already (in the 15 years between 2009-2026) have provided over R300 billion of direct equity injections to Eskom – with very little meaningful impact on Eskom's return to sustainability. Adding another R200 billion to this, without resolving all the other issues at the same time, will be a temporary band-aid solution which we believe will not return Eskom to long-term financial sustainability.

In this context we believe the shareholder needs to be sharp-sighted about the intention behind this debt solution and its limitations as a standalone remedy – it must recognise that without speedy and meaningful execution on the other interventions, this support will follow the path of the R240 billion that has already been allocated to Eskom since 2009. It should enrage us as citizens and taxpayers that, despite substantial amounts of money already allocated and spent, Eskom is not yet financially or operationally sustainable. After all, bailouts are funded from the fiscus, which itself is funded by taxpayers - individuals and corporates.

While we recognise that the Minister is likely limited in the degree of detail he can provide in the Budget Speech on Wednesday, we do expect that whatever interventions are outlined, these will be further publicly elaborated on in the days following the Speech, such that we will have the required clarity and detail on the six key requirements outlined in this note.

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[4] Source: RMB Markets report "Eskom's debt and the MTBPS – it's complicated", 18 October 2022, p6, author: Kate Rushton

Table 3: Government support – a fifteen-year view

Rbn	FY09	FY10	FY11	FY16	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Amount	10	30	20	23	49	56	31.7	21.9	21	22	23
		Subordinated loan converted to equity								February 2022 budget speech	

Source: Eskom, RMB Markets

We will publish a follow-up article after the Budget, in which we will assess the proposed solution as against these questions:

a. Is a clear commitment to treat all creditors fairly contained in the proposal?

b. Is it clear that the proposal will not trigger any of the ratings agencies or loan agreements' definitions of a default or a debt restructure?

c. After implementation of the solution, will the level of debt on Eskom's balance sheet be sustainable, given Eskom's cashflows and operating environment?

d. Has the required level of detail been provided on any conditions that may be imposed, together with the consequences and/or concomitant actions following any non-compliance with the proposed conditions?

e. Is the relief immediate or staggered, and is the profile such that it ensures that Eskom does indeed return to standalone financial sustainability?

f. Do we have clarity on Eskom's future funding needs, the likely sources of this funding, and does this plan ensure Eskom's standalone financial sustainability over the medium- to-longer term?

We will also need to assess the actions of the various stakeholders in the coming weeks on the other matters integral to a solution, namely: tariffs, costs and municipal debt.

Delays, half-measures and "kicking the can down the road" are not going to get the results the nation needs. Bold, urgent and integrated intervention on Eskom is extremely overdue. This is what we are looking for when the Minister rises to speak at 14h00 on Wednesday.

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