Eskom's revenue application for 2018/19

Presentation to NERSA public hearings

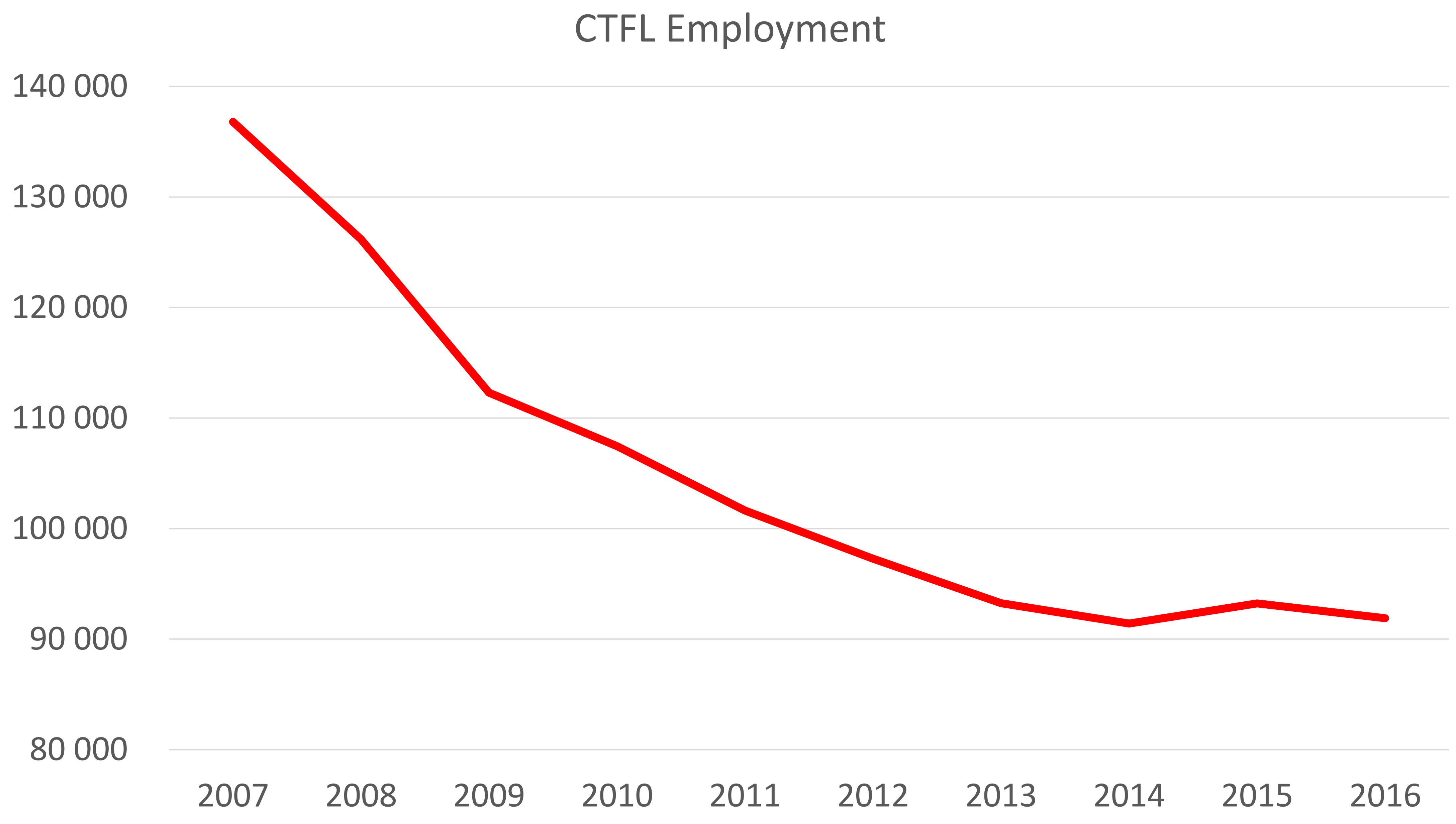
30 October 2017

SACTWU & CTFL Sector

- Organises clothing, textile, footwear, leather and related workers
- +100 000 members
  - Black, female, and sole breadwinners
- Low-paid
- Geographically dispersed
  - In major cities
  - In industrial towns
- CTFL: most labour intensive sector of manufacturing
  - Textiles: energy intensive part

State of the Industry

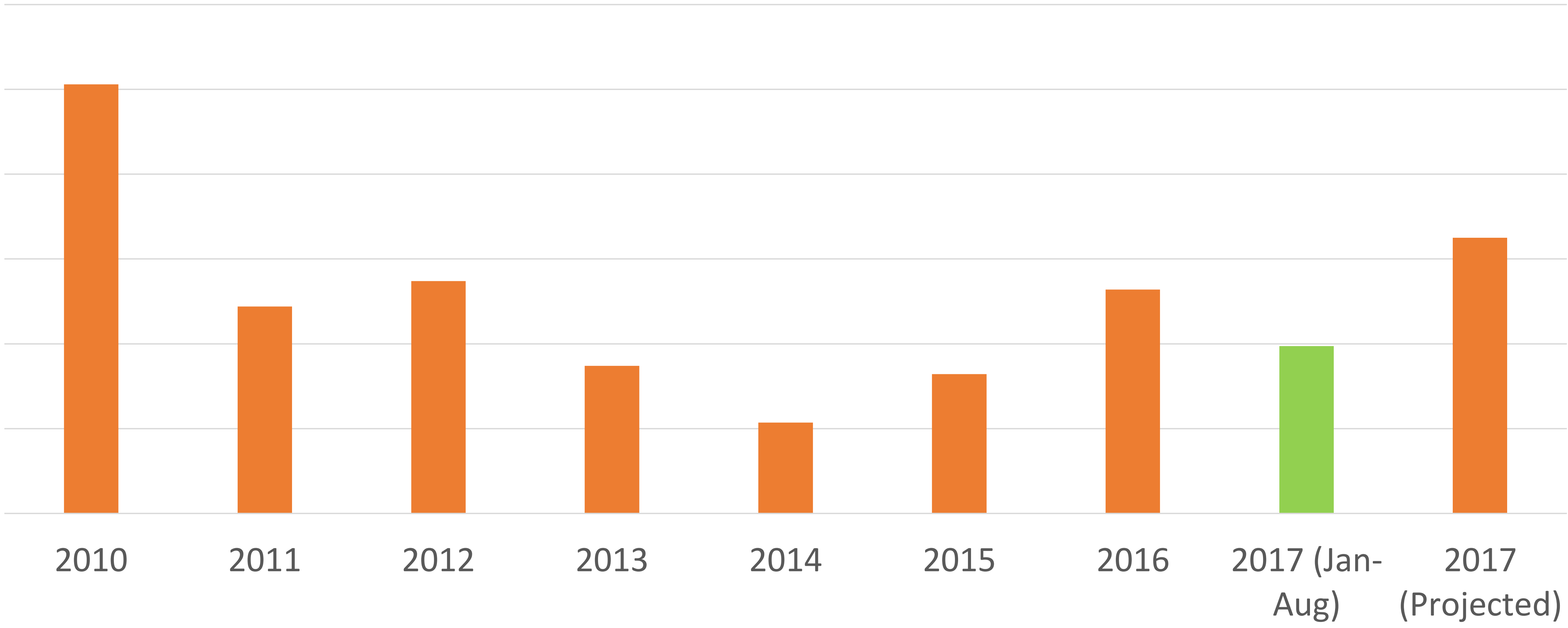
- Jobs bloodbath: +170 000 CTFL jobs lost since 1996
- Stabilised over past five years through smart industrial policy
  - Incentives & loans to recapitalize
  - Government procurement


CTFL Employment
140 000
130 000
120 000
110 000
100 000
90 000
80 000
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016

State of the Industry

- But tide beginning to turn again
  - Sluggish economic climate
    - Slump in retail sales and corporate demand
    - Budgetary cuts in the State reduces government procurement demand
  - Decline in SARS effectiveness leads to unmanaged illegal imports
  - Credit downgrade and low growth forecasts heighten threats

Job Loss Trends



Proposed Eskom increase will compound CTFL and manufacturing problems dramatically…

Envisaged outcomes of 19.9%

- Tip struggling companies into freefall
  - CTFL industry is low margin business with enormous pressure from imports
  - Very little supplier power in value chain and cannot pass costs to customers
- Catalyze retrenchments and factory closures/ deindustrialisation
  - Particularly impact more capital intensive textile factories
- Cause further downstream instability for clothing and homextile producers – the very labour intensive parts
- Further loss of confidence in SA economy and withdrawal of existing and future investors
- Lead to further importation and skewed balance of payments

Workers - as always - will bear the brunt…

…Job losses and unemployment will increase, and

…Future employment growth opportunities will be squandered

Questioning rationale for the increase

- How can Eskom justify increase when it exhibits serious mismanagement of public monies?
- What security that additional revenue will be prudently used?
- Request for tariff increase is shaking public and investor confidence further instead of satisfying stakeholders that SOEs and economy are in safe hands
- Is this an avenue to beat public into submission in order to present nuclear as viable alternative at some stage?

Focus on textiles

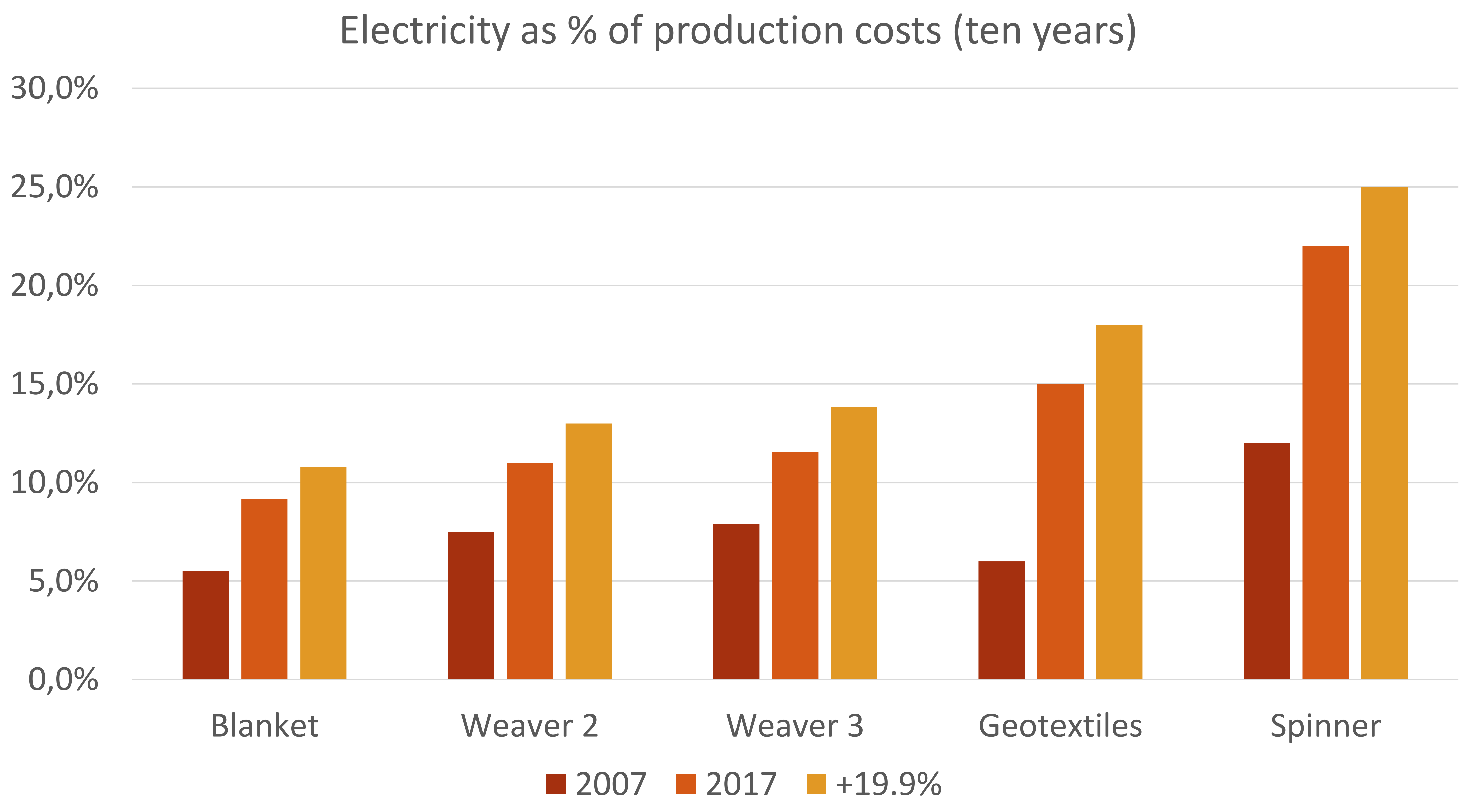
- Over 150 companies nationally
- +R20bn sales and +24 000 employees
- Feeds various value chains:
  - apparel,
  - technical and industrial,
  - home and lifestyle

Big 10

- Surveyed 10 of the biggest & most important textile factories
  - Most energy intensive
    - 1 fibre producer, 1 spinner
  - Mid
    - 3 weavers, 1 geotextiles, 1 non-woven, 1 bulk bags
  - Least
    - 1 blanket, 1 knitter
- Province
  - 7 plants in Kzn
  - 4 plants in Western Cape
  - 1 Gauteng
  - 1 Eastern Cape

Electricity vs other manufacturing costs – 10 years

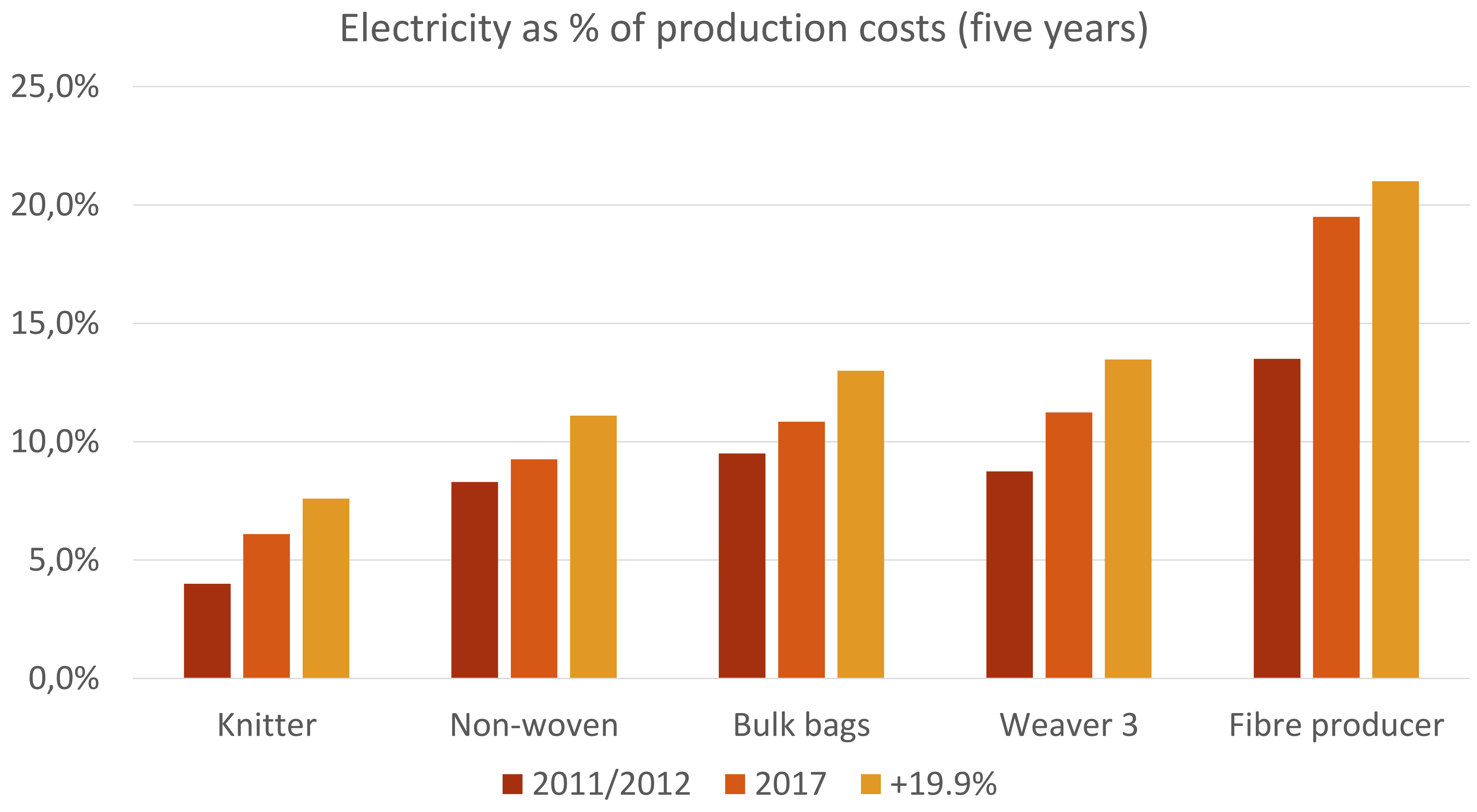
- Electricity increasing much quicker than other costs
- Electricity as % of production cost – average
    - 2007: 7.8%
    - 2017: 13.7%
    - After 19.9% increase: 16.1%
- So doubling in ten years



Electricity as % of production costs (ten years)
30,0%
25,0%
20,0%
15,0%
10,0%
5,0%
0,0%
Blanket
Weaver 2
Weaver 3
Geotextiles
Spinner
2007
2017
+19.9%

Electricity vs other manufacturing costs – 5 years

- Electricity as % of production cost – 2011/12 vs 2017 average
  - 2011/12: 8.8%
  - 2017: 11.4%
  - After 19.9% increase: 13.2%
- So 50% increase in about 5 years


Electricity as % of production costs (five years)
25,0%
20,0%
15,0%
10,0%
5,0%
0,0%
Knitter
Non-woven
Bulk bags
Weaver 3
Fibre producer
2011/2012
2017
+19.9%

So what?

- Foreign competitors are not subject to similar overhead price increases, so SA can't compete against imports

Blanket: "The proposed increase will directly and negatively affects our competitiveness, as imported goods are likely subject to a year-on-year increase in utility costs of a mere fraction of the Eskom request, which would make us less competitive"

- Any price increase above inflation will see customers turning to imports

Weaver: “Raw Material prices + CPI has been the norm in negotiating price increase with customers. However, as a result of the current state of the economy, customers have no appetite for price increases”

Geotextiles: “Currently, to compete against imported products we are having to price at single-digit profit percentages. Add another 6% to the costs and we will not be breaking even on this product”

- If factories pass on their higher costs, they can expect a drop in sales

Knitter: “Due to the depressed economy and international competition such a huge proposed increase could never be passed on to our selling prices and so factories have to swallow them. This will further burden our already heavily-burdened production costs”

Blanket: “We have to increase sales to keep GP margin and cover increased costs but it is not possible in current climate”

- Increases at textiles affect the entire value chain, including the most labour intensive part, clothing

Spinner: “Spinners are big users of electricity and this proposed increase is going to impact the cost of yarn manufacturing significantly. This will then put pressure on the competitiveness of the entire supply chain, threatening jobs further”

- A big electricity tariff increase will see suppliers increasing their prices with negative consequences for textile factories

Geotextiles: “Coupled with our own increase, it is likely that our raw material and packaging suppliers will pass on the increase which again we will have to absorb”

- The above could lead to job losses

Weaver: “When a business is trading on a break-even/loss position, increases like this can be the final straw”

Knitter: “We may have to cut 20-50% of jobs as we will have to downsize operations”

Blanket: “Downscaling a possibility”

Geotextiles: “Downscaling a real possibility”

Case studies

Spinner

- Cotton spinner with 260 workers in Hammarsdale, KZN
- Major part of several local value chains; owned by the IDC
- Electricity as % of manufacturing costs:
  - 2007: 12%; 2017: 22%; post-19.9%: 25%
- Currently it is able to compete with imports because of customs duties

Impact of 19.9%

- “With this increase, we will become more expensive and therefore less competitive. Our profitability would decrease by R6m per annum because we believe that the increases attributable to this increase in electricity would not be absorbed by the market. We would have to absorb it
- If we do not remain competitive retailers will simply switch to imports
- If we absorbed this impact it would become a very marginal business threatening not only the livelihood of it 260 employees but also circa 6000 employees converting its yarn into finished product
- This despite having invested in the latest technology and taking all possible measures to reduce electricity consumption.”

Fibre producer

- Poly fibre producer, using recycled plastic bottles as input, in Milnerton, Western Cape
- Electricity as % of manufacturing costs:
  - 2011: 13.5%; 2017: 19.5%; post-19.9%: 21%
- Cost of electricity per kg of production:
  - 2011: R0.63; 2017: R1.32; post-19.9%: R1.57
  - 150% increase in six years

Impact of 19.9%

- “We have been a business that operates on very low margins and we are just above the breakeven point
- We do not envisage or have plans for retrenchments but increases of the nature proposed of any costs item increases the risk in businesses that are operating at breakeven margins”

Weaver

- Cotton and poly-cotton weaver in Zwelitsha, Eastern Cape, employing at least 600 people
- Electricity as % of manufacturing cost:
  - 2007: 7.5%; 2017: 11.0%; post 19.9%: 13.0%
- Product example: D59 workwear fabric
  - Increase in cost per meter R0.25
  - But with 1.5m metres per month: R375,000 / month
  - Impact on gross profit annually: R4,125,000 / month

Impact of 19.9%

- “Workwear products such as the D59 are marginal in terms of profitability due to the pressure on selling prices as a result of imports, which is a big part of the market. Any increase in the cost that cannot be passed on to the market has a direct impact on profitability
- We have made losses this year and are under pressure in terms of sustainability into the future. Any increase in costs, let alone a nearly 20% increase in Eskom charges, will make things even tougher in terms of remaining competitive and ensuring continued business”

Geotextiles

- Geo- and technical textile producer with plants in KZN and WC, supplying Eskom, infrastructure projects and construction
- Electricity price:
  - 2007: R22.34 /kwh; 2017: R72.55 /kwh; post 19.9%: R86.98 /kwh
- Electricity gone up year on year by 12.5% from 2007 to 2017
- If these increases had been in line with inflation our price today would be R40.20 /kwh compared to R72.55

Impact of 19.9%

- "As we are so closely linked to the construction industry and given the reduced spending by government and the private sector in this sector, our margins have been decreasing consistently since 2015
- This increase will compound the issue and will no doubt reduce margins further as we are not in a position to pass this increase onto our customers in the short-term and will have to absorb the increase until the market picks up.
- Our second most important production line is very sensitive to import competition. Effect of each of our suppliers passing on their increases will see our costs of this product increase by close on 6%. Currently to compete against imported products we are having to price at single digit profit percentages. Add another 6% to the costs and we will not be breaking even on this product"

Conclusion

- Not just textiles, also manufacturing
  - Undo govt efforts to reindustrialise
- After 19.9%, electricity costs as % of manufacturing costs will have almost doubled over the last ten years
- Weak economy and import competition mean price increases cannot be passed on
- Very low margin sector so this squeezes other costs, incl workers' wages, raw material costs and any profit margin
- Ultimately, retrenchments and factory closures

Eskom's application for a tariff increase

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