

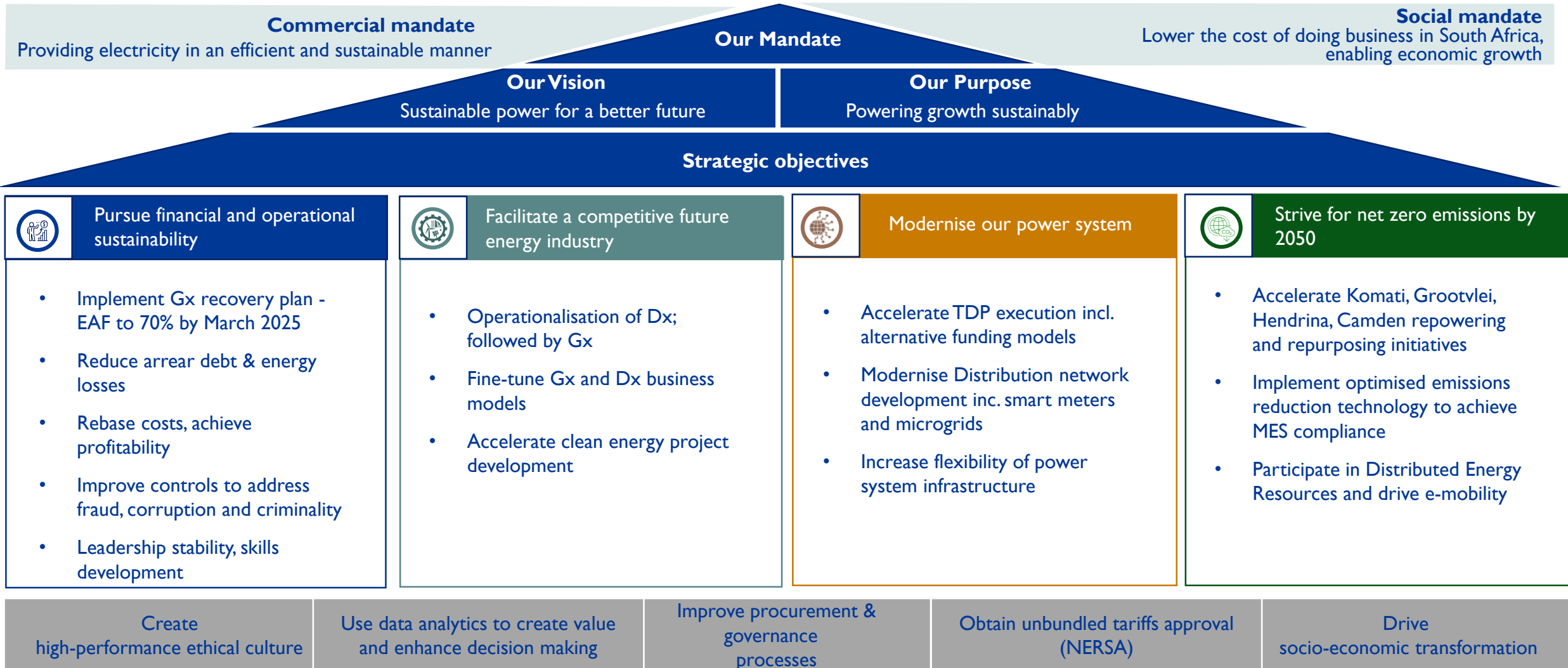
MYPD 6 Application

**NERSA Public Hearings
Cape Town**

18 November 2024



The Eskom Strategic turnaround is based on four strategic objectives to deliver the organisation's dual mandate



OUR VALUES:



Zero Harm



Integrity



Innovation



Sinobuntu



Customer Satisfaction



Excellence

Background

- ❑ The Multi-Year Price Determination (MYPD) 5 revenue determination period comes to an end on 31 March 2025
- ❑ **Revenue applications are guided by the Electricity Pricing policy (EPP), Electricity Regulation Act (ERA) and NERSA's MYPD methodology (2016)**
 - Must enable an efficient licensee to recover the full cost of its licensed activities, including a risk adjusted return
 - Ensure Eskom's sustainability as a business and limit risk of excess or inadequate returns, while providing incentives for new investment
 - Eskom is required to make a compliant application in terms of the MYPD methodology
- ❑ Eskom wishes to be in a position to continue to provide an electricity service to customers
- ❑ Based on forecasts which serve as assumptions that correspond to a revenue requirement
 - **Eskom has motivated the application using the latest projections**
- ❑ Revenue determination is made by NERSA based on assumptions
 - Variances between determinations and actuals are addressed after the FY through the Regulatory Clearing Account (RCA)
 - In practice, the RCA process has risks with recovery of efficient variances 3 to 6 years after expenditure incurred
- ❑ **Have considered impact on consumer by phasing of return on assets for migration towards cost reflectivity at revenue level**
- ❑ Have made ringfenced revenue applications for Generation, NTCSA (Transmission) and Distribution
 - Expect NERSA to make ringfenced revenue determinations to facilitate unbundling
- ❑ The Electricity Regulation Amendment Act (ERAA) has been signed into law by the President on 16 August 2024, and is awaiting announcement of the effective date
 - Await NERSA transitional arrangements to plot way forward
- ❑ The Retail Tariff Plan to restructure the tariff is currently being consulted on



The Government electrification programme

Facilitation of access (cost of connecting a house) to a 20A (low consumption) electricity supply.

- This complements an already subsidised tariff.



Free basic electricity (FBE)

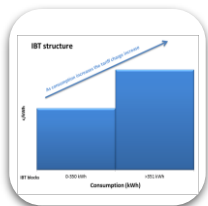
Social grants provided directly to customers through Free Basic Electricity of 50 kWh per household per month by national government to the indigent through the Equitable Share Fund.

- Eskom provides FBE to customers in their area of supply as an agent for the municipalities



Subsidised Eskom tariff

- For MYPD3 period and subsequently Homelight 20A customers (lifeline tariff) was lower than the average increase.
- Subsidised by direct Eskom large urban customers through the **affordability subsidy**
- The continual implementation from this lower base allows for extension of an effective subsidy
- Homelight 20A customers pay one third less than other residential customers in FY 2025 for block 1



NERSA Inclining Block Rate (IBT)

The IBT was implemented by NERSA to cushion low-income households that use very little electricity

- Eskom believes that the IBT as it is currently structured does not sufficiently target low-income households and places an unsustainable subsidy responsibility on urban customers.

Eskom's application is only for efficient costs

The guiding legislation (ERA) allows only for the recovery of efficient costs

NERSA has various requirements to ensure that only efficient costs are applied for

- NERSA requires the MYPD methodology to be followed and provides detailed guidance on how an application is to be made
- NERSA requires the prudence assessment criteria to be applied, as applications are made
- Eskom provides detailed information that supports its application

NERSA makes assessments for efficient costs

- These are based on the MYPD methodology and prudence criteria
- It is expected that NERSA will also make decisions within these regulatory frameworks and provide the relevant benchmarks, comparisons and motivations
- NERSA also provides reasons for its decision

Corruption and fraud continues to be addressed

- Eskom is making every effort to ensure that processes are in place to address possible fraud and corruption
- NERSA has provided guidance on addressing any recoveries

We are making progress in stopping the leakage by addressing fraud and corruption



- Eskom has **intensified its focus on environmental, social and governance matters** to rebuild Eskom as a high-performance, ethical and values-driven organisation
- Recommendations from interventions include:
 - **Instituting criminal charges**
 - Ensuring appropriate consequence management against employees and suppliers - all implicated suppliers have been blocked provisionally
 - **Pursuing director delinquency proceedings** – all implicated directors have been removed from the employ of Eskom. Legal proceedings to follow
 - Civil recovery of financial losses suffered by Eskom
- Eskom is also **re-evaluating the effectiveness and making relevant changes to policies, processes, systems, controls and structures** where necessary
- Consequence management: establishment of an external disciplinary tribunal, to expedite disciplinary action and address the backlog of cases.

NERSA methodologies allows Eskom to recover only efficient costs through tariffs to be charged to customers



Regulatory framework for tariff determination

Revenue Level

1 MYPD (decision Dec-24) + RCA

Determination of the required level of annual revenue, typically known as the revenue requirement

Cost + return
Gx, Tx, Dx and retail

Volume

Average price and price increase

Tariff Structure

2 Cost to serve/supply

Apportionment of revenue among customers with distinctions made between customer-, demand- and energy-related costs classes

Cost to serve

Cost functionalisation
Gx, Tx, Dx and retail

Cost causation and cost drivers

Cost reflective unbundled unit costs

Tariff Level

3 ERTSA (decision Mar-25)

Individual prices, formally known as tariffs or rates, are designed in order to collect the assigned level of revenue from each class

Tariff design

EPP, Codes, Strategic provides direction

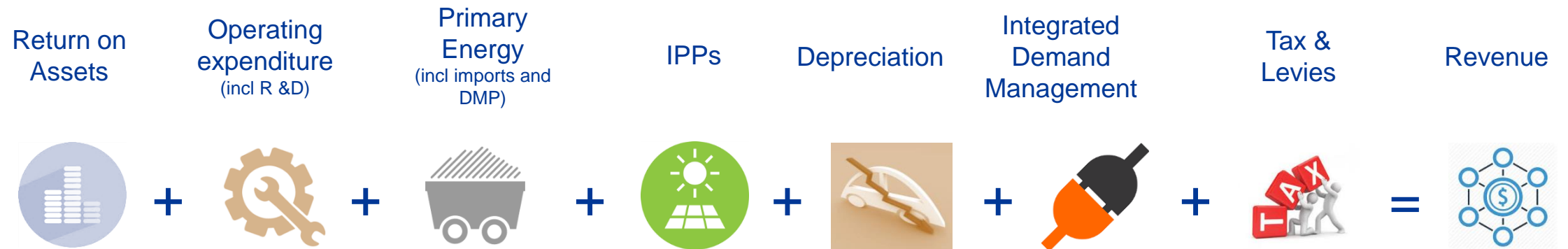
Design - unbundled or bundled, affordability

Once approved by NERSA implementation

Retail Tariff Plan – restructure of tariffs to best reflect the costs for each function (**decision expected Jan-25**)

NERSA's MYPD methodology requires Eskom to provide costs in terms of this allowable revenue (AR) formula

$$AR = (RAB \times WACC) + E + PE + D + R\&D + IDM + L\&T$$



Return on assets = % cost of capital allowed X depreciated replacement asset value

This internationally recognised methodology, if implemented (even in a phased manner) would allow for recovery of efficient costs and a fair return

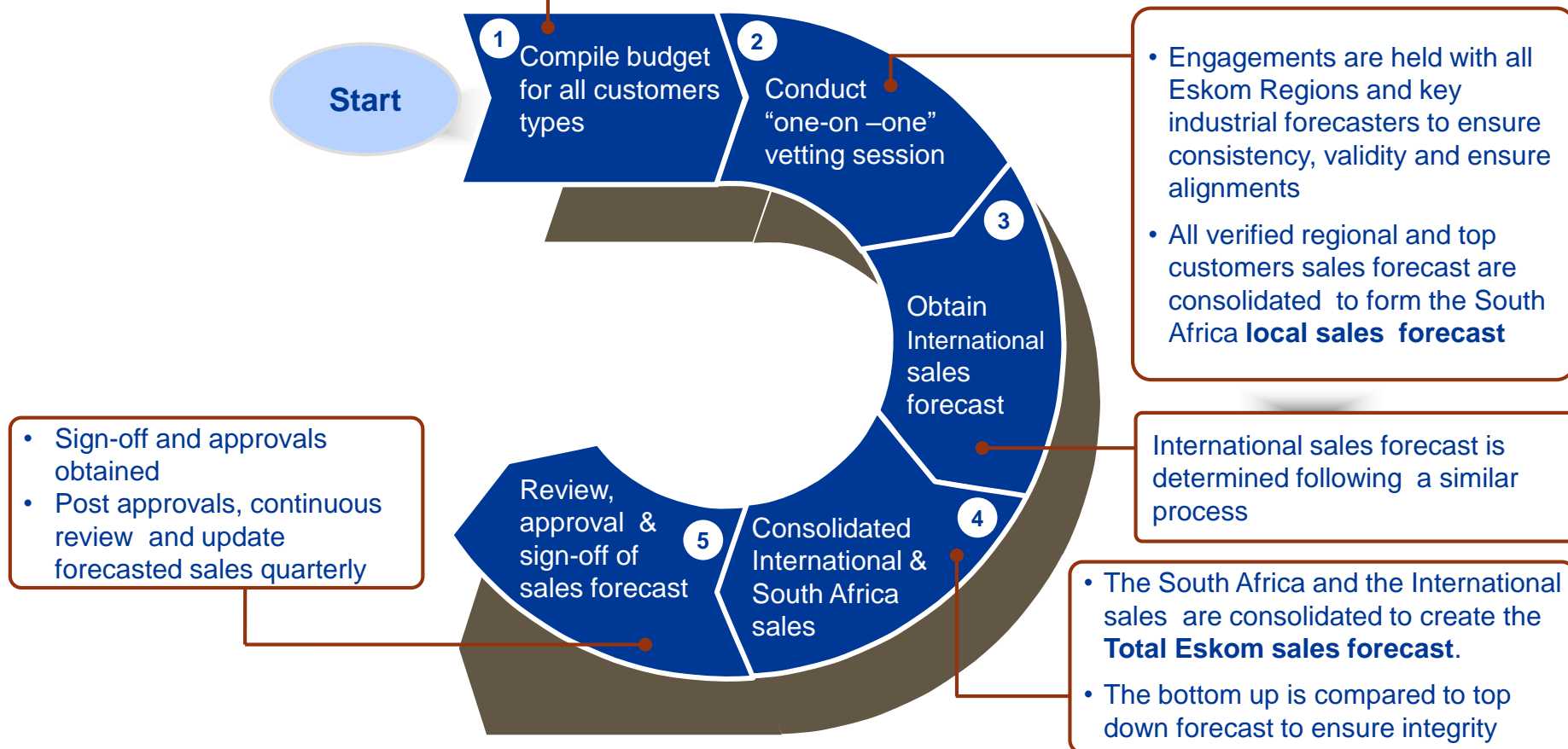
Eskom allowable revenue required to supply electricity for the period FY2026 to FY2028



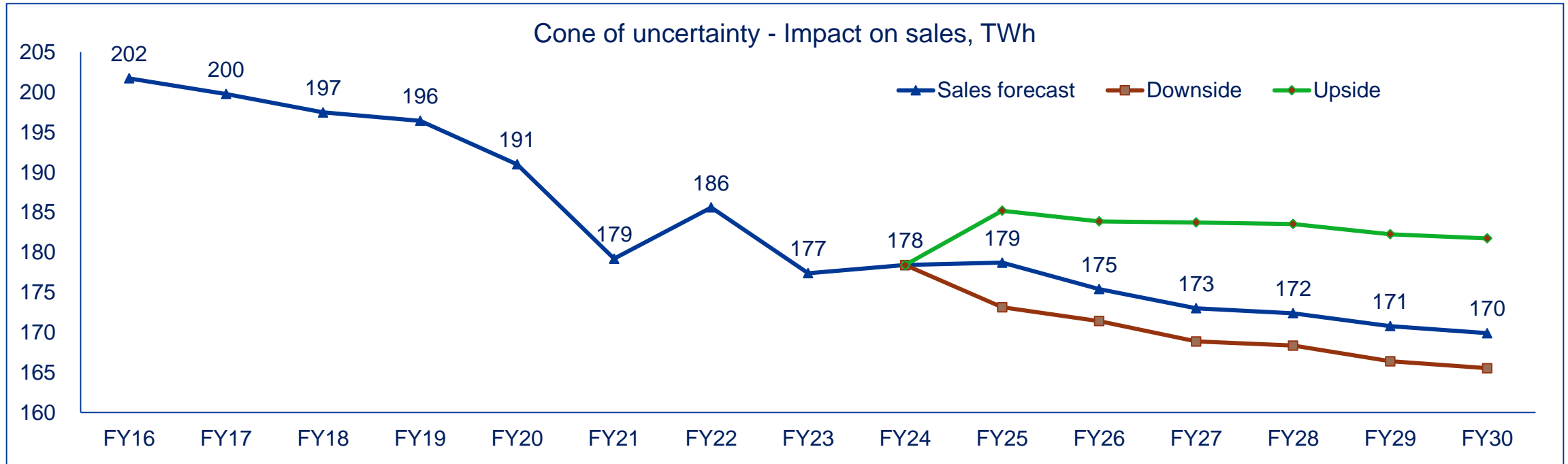
| Allowable Revenue (R'millions) | AR | Formula | Decision FY2025 | Application FY2026 | Application FY2027 | Application FY2028 | Post Application FY2029 | Post Application FY2030 |
|---|------------|---------|-----------------|--------------------|--------------------|--------------------|-------------------------|-------------------------|
| Regulated Asset Base (RAB) | RAB | | 988 345 | 1 066 724 | 1 192 878 | 1 219 244 | 1 243 078 | 1 278 277 |
| WACC % | ROA | X | 1.58% | 4.00% | 5.00% | 6.00% | 7.47% | 9.69% |
| Returns | | | 15 616 | 42 669 | 59 644 | 73 155 | 92 908 | 123 916 |
| Primary energy | PE | + | 92 816 | 128 000 | 133 061 | 128 869 | 129 492 | 134 119 |
| International purchases | PE | + | 9 334 | 10 262 | 9 737 | 13 656 | 11 853 | 12 387 |
| IPPs | PE | + | 76 970 | 66 633 | 77 640 | 109 820 | 135 510 | 140 943 |
| Environmental levy | L&T | + | 6 503 | 6 539 | 6 279 | 5 337 | 4 781 | 4 767 |
| Carbon tax | L&T | + | - | 5 534 | 21 291 | 19 895 | 19 274 | 20 948 |
| Arrear debt | E | + | - | 8 914 | 9 917 | 10 752 | 12 037 | 13 310 |
| Operating costs | E | + | 61 442 | 93 315 | 93 834 | 97 864 | 100 152 | 105 100 |
| Depreciation | D | + | 73 376 | 66 931 | 69 952 | 77 431 | 79 685 | 85 961 |
| MYPD6 Allowable Revenue | | | 336 057 | 428 798 | 481 355 | 536 778 | 585 691 | 641 450 |
| Add: Approved RCA/court order for liquidation | RCA | | 16 109 | 16 765 | 14 000 | - | - | - |
| TOTAL MYPD6 Allowable Revenue | R'm | | 352 166 | 445 563 | 495 355 | 536 778 | 585 691 | 641 450 |

Eskom follows a rigorous sales forecasting approach which can take at least 9 months to complete

- A **six year monthly forecast** is compiled – supported with another 4 years into future on annual basis using trends per sector
- Forecast for top customer segments (consuming greater than 100 GWh per annum are **individually analysed** considering customer insights, market conditions, usage patterns and long term plans)
- **Bottom-up approach** (regional inputs) is applied together with Pareto principle to determine the forecast for rest of other customer base – customers (including municipalities that make up 80% of the sales per category are forecasted on an individual bases.)



Cone of uncertainty: possible upside and downside



- ❑ The decline in sales can generally be attributed to large power users as a result of low competitiveness, high ore extraction costs, and volatile commodity markets – particularly in the ferrochrome, steel, gold, and platinum industries.
- ❑ It is important to emphasise that the South African economy had shown signs of significant distress prior to the onset of the pandemic and its associated lockdowns
- ❑ Although South Africa is still viewed as an emerging market, several factors have contributed to the decline in underlying economic growth of the country. These include finite natural resources, low investor confidence, infrastructure bottlenecks, labour unrest, load shedding, rising local debt, and unemployment

Dominant factors and drivers of electricity demand and thus sales volume

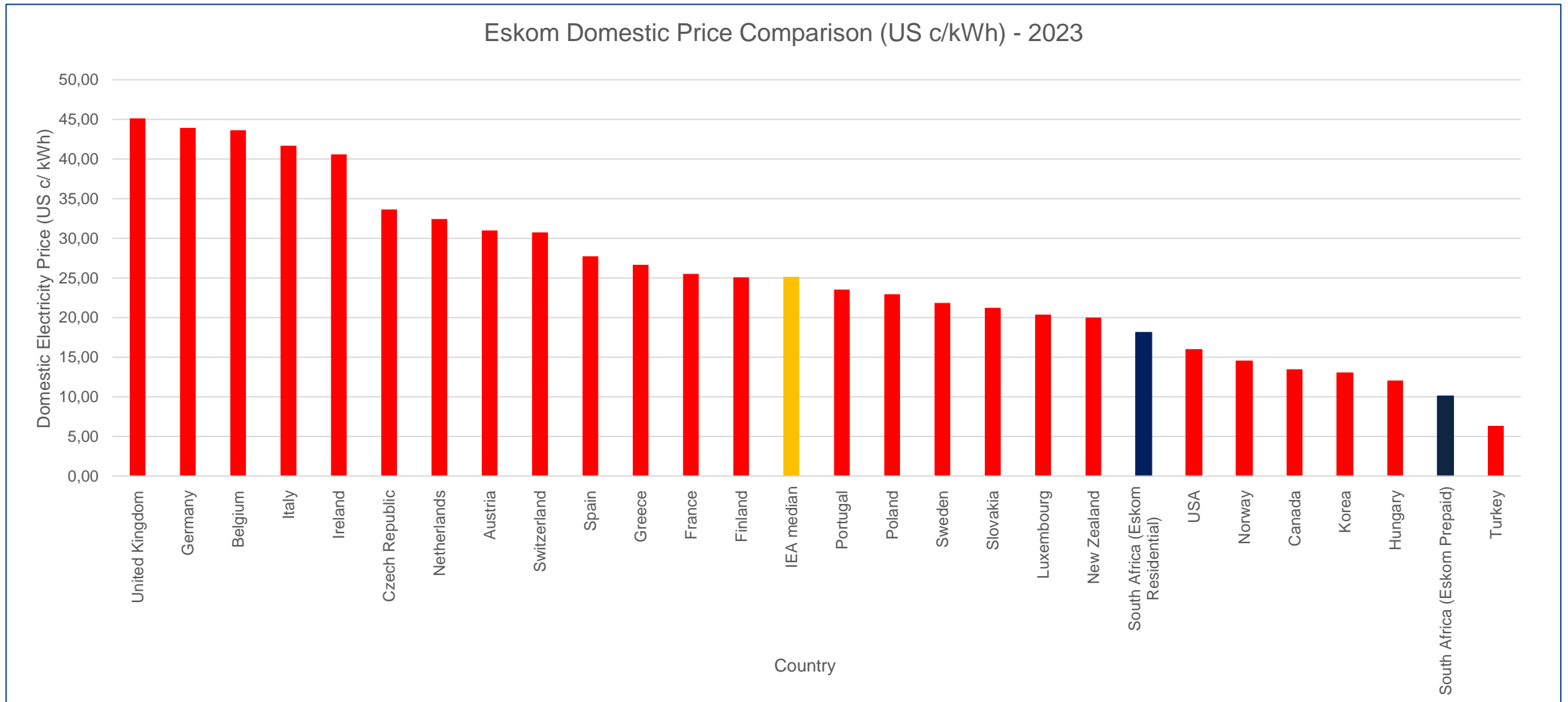
- Overall **national economic growth**; commodity prices;
- Structural changes to the economy (e.g. reduction of mining and manufacturing and growth in services),
- Technological changes, electricity intensity levels.
- Population growth,
- Weather patterns,
- **Policy drivers on investment** choices have been found to be paramount.

Other operational factors that impact sales of electricity in South Africa

- Low **international economic growth**
- Commodity market volatility
- Rapid evolution of technology in the energy industry
- Some **large power users** have been **liquidated** or applied for **business rescue** due to **financial vulnerability** and low competitiveness
- Some industries that have shut down operations and **relocated to Asia due to incentives offered** in those countries
- Voluntary contribution to the energy reduction strategies during load shedding accelerated energy efficiency and self-reliance
- Opting to export un-beneficiated ore due to high market prices
- **Labour costs** and labour relations
- Reliability and cost of logistics

Despite the escalating costs, Eskom's domestic electricity price is lower than in most countries

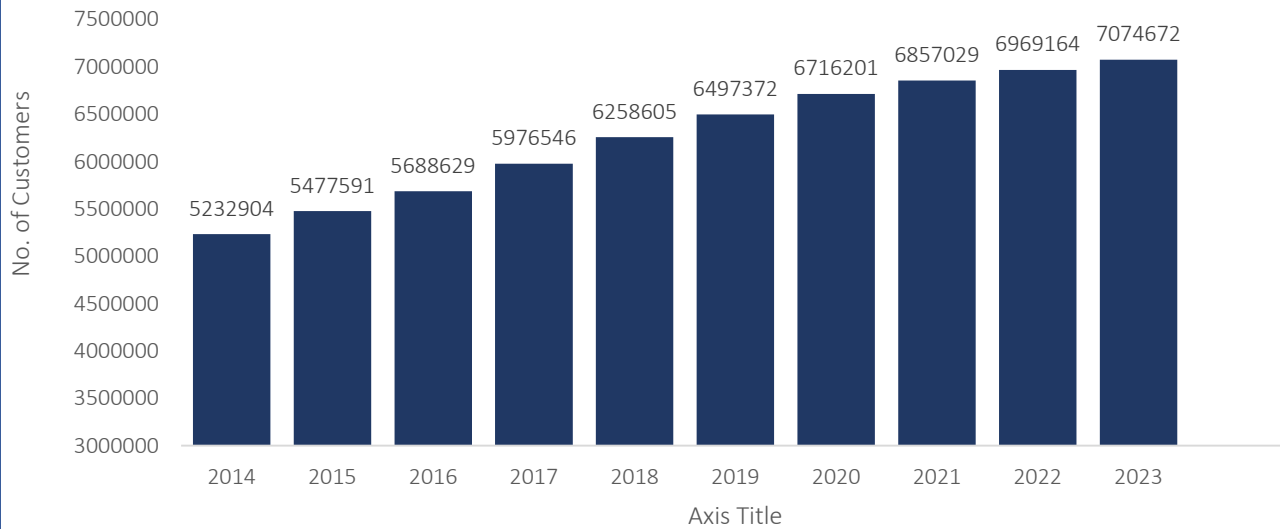
Eskom Domestic Price Comparison (US c/kWh) - 2023



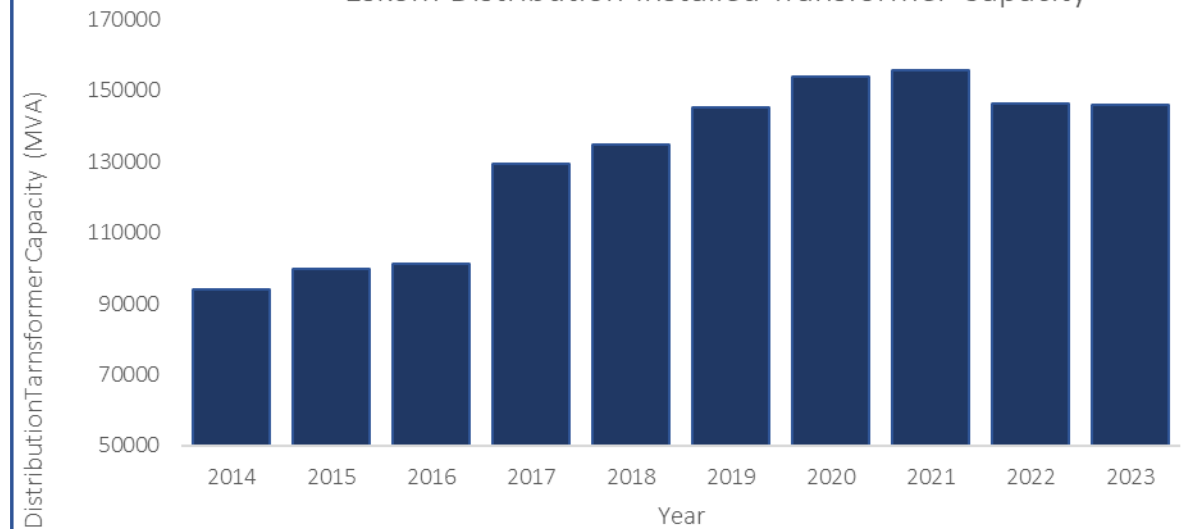
Eskom's has increased its Assets & Customers over the years



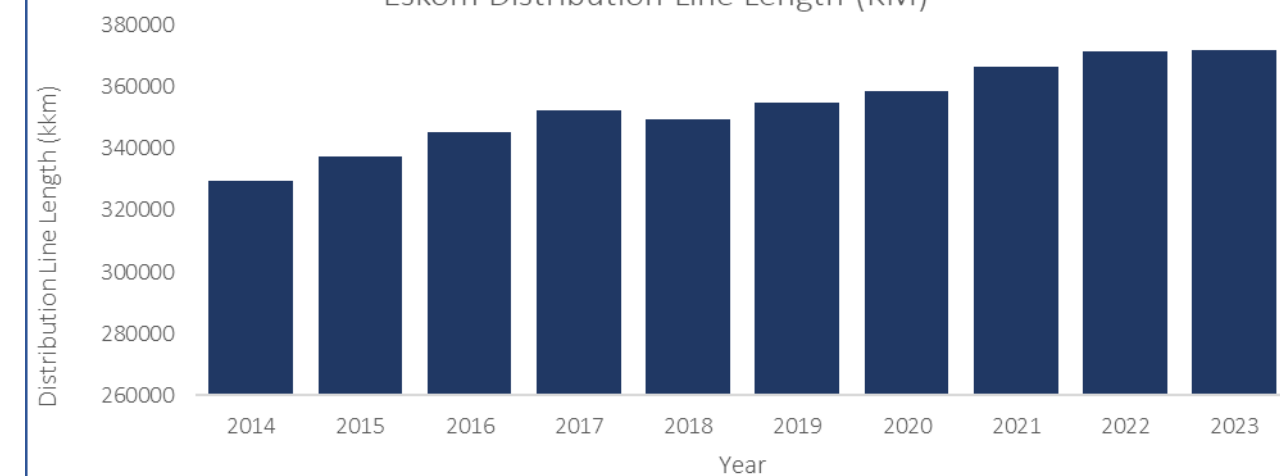
Eskom Number of Customers



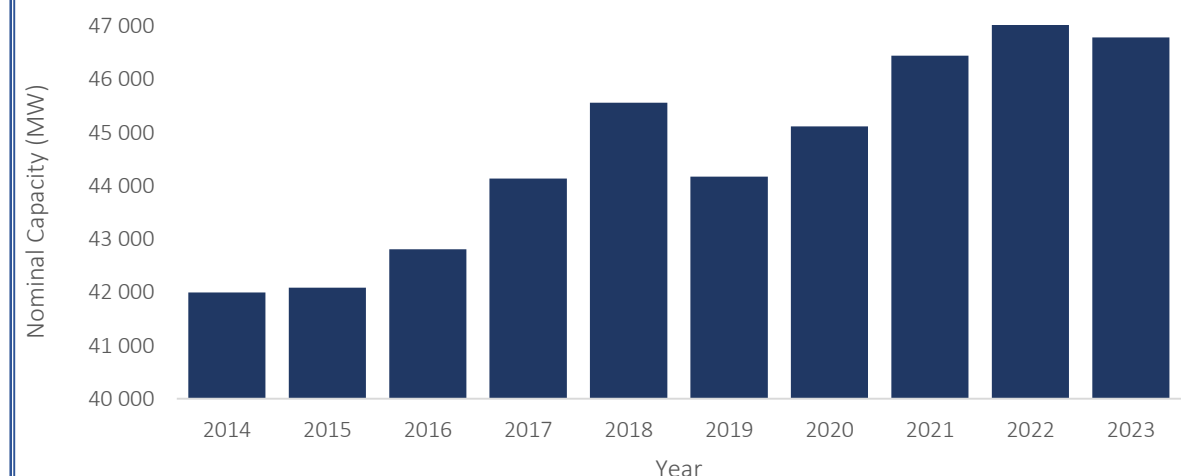
Eskom Distribution Installed Transformer Capacity



Eskom Distribution Line Length (KM)

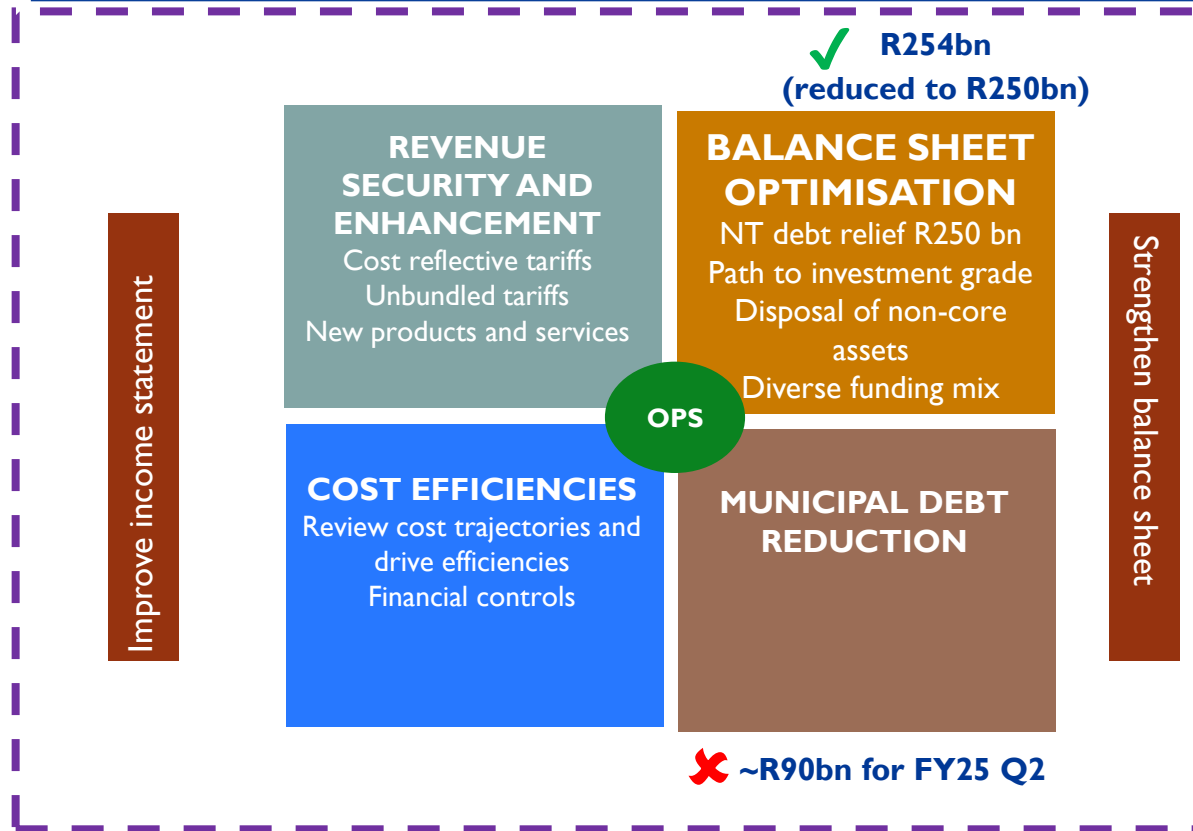


Generation Capacity(MW)



The tariff increase is a key component to achieving Eskom's financial turnaround

Pillars of our financial strategy



Insights

- Four pillars to financial recovery: (1) **Revenue security**, (2) **debt reduction**, (3) **cost containment** and (4) **reduction in municipal non-payment**
- We have implemented **cost efficiencies** in our cost base, for the last 3 financial years. To date operational performance has led to reduce diesel expenditure.
- The **debt relief** allowed the business to manage its high debt service costs and cash, to allocate the financial resources needed for Generation (to address the maintenance backlog and adequately prepare for outages). This served as the critical precursor for improved plant performance and financial recovery
- Limited success with the Municipal Debt Relief programme** with low adherence to the debt relief conditions. Municipal debt including metros **growing by more than R12 bn/annum**
- All four pillars need to be addressed at the same time if Eskom is to become financially independent

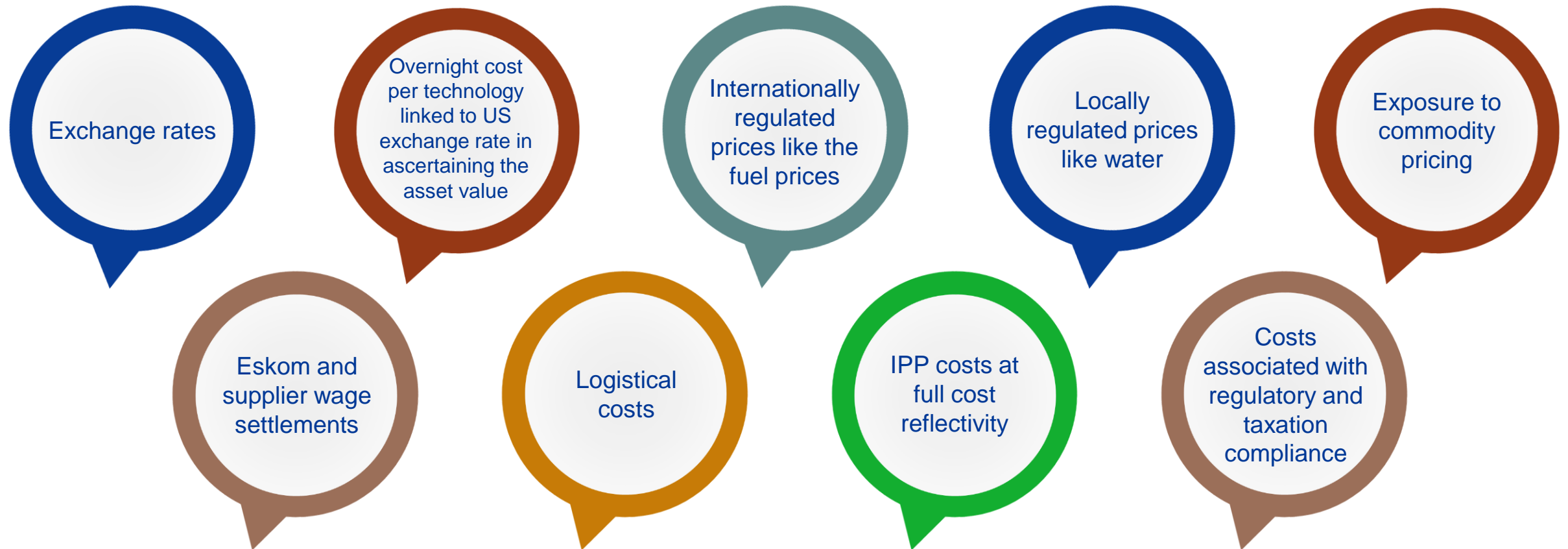
Key risks



- 1 Tariff
- 2 Gx plant performance
- 3 IPP delays
- 4 Municipality non-payment
- 5 Unsustainable borrowings on the balance sheet

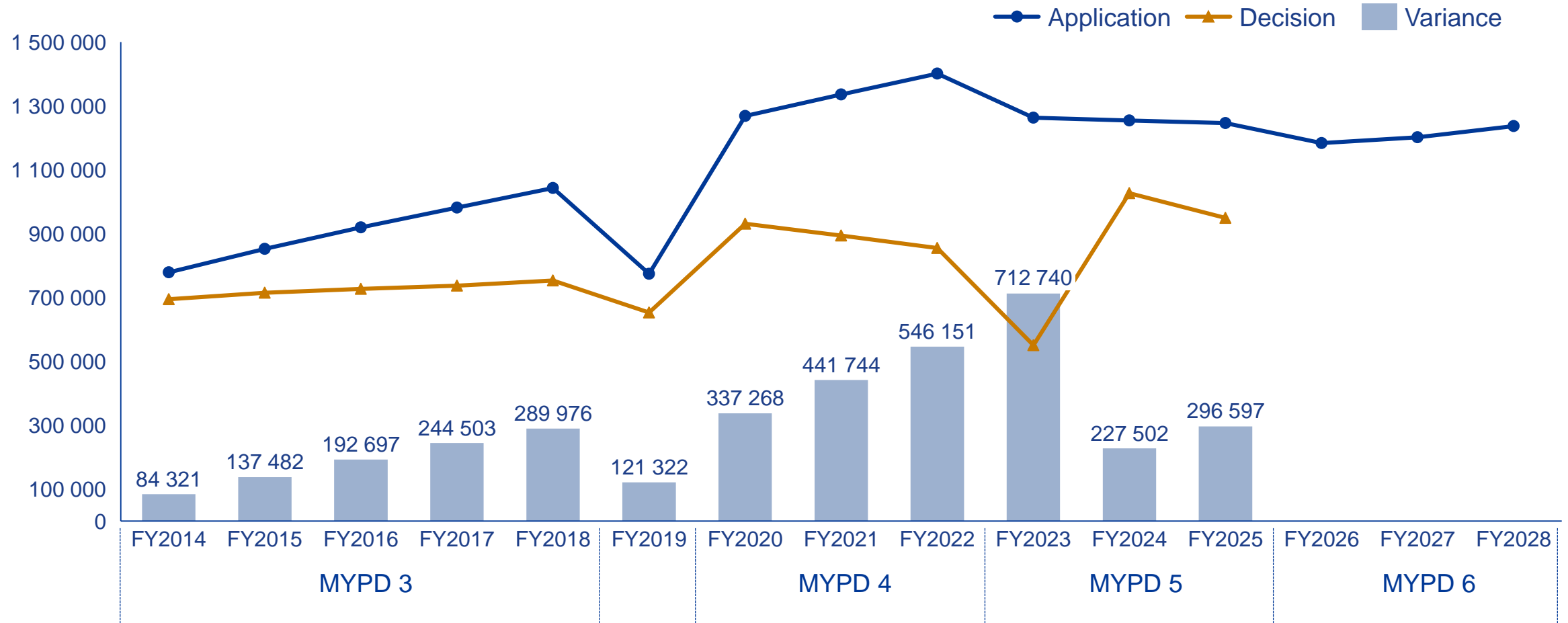
Eskom's cost drivers are not linked to CPI

CPI – shows trends in a bundle of household goods - not costs to produce electricity

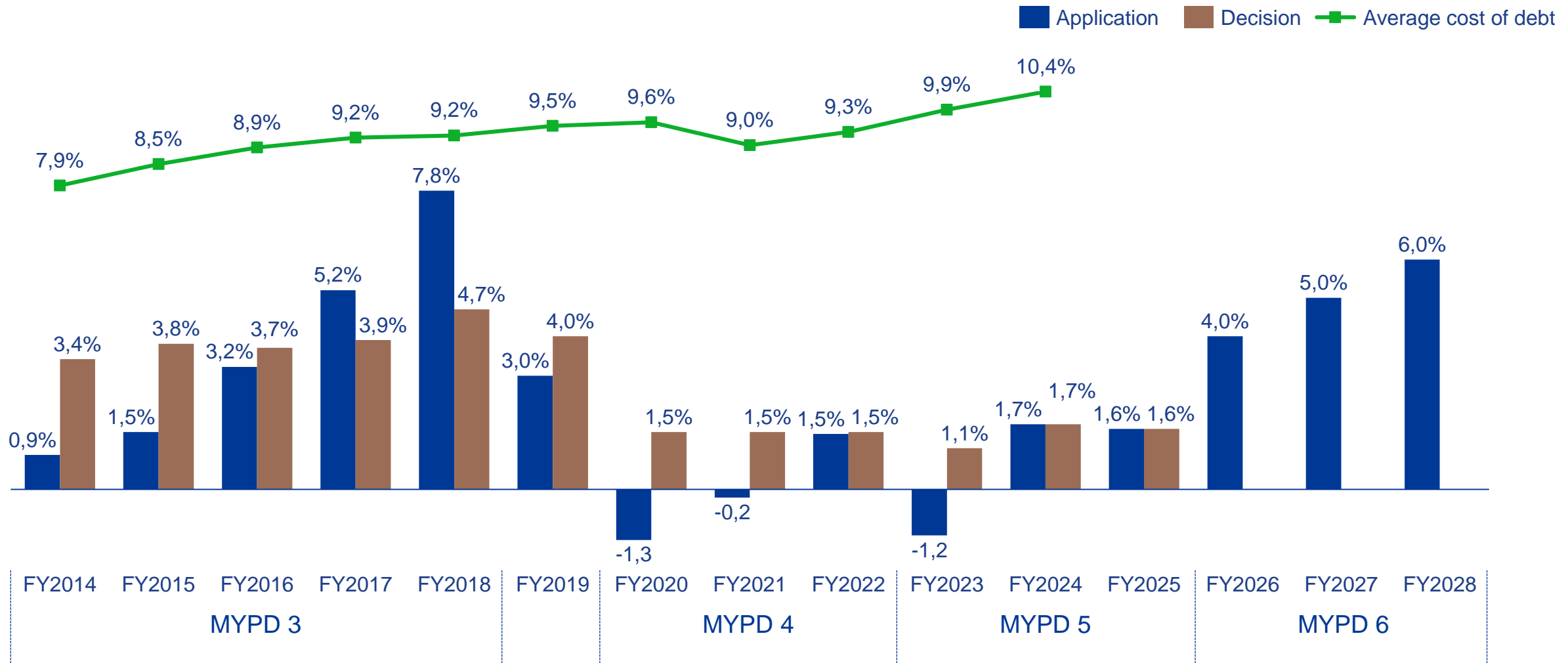


Ultimately, majority of the drivers for Eskom's costs are independent of CPI

The difference between Eskom's application and NERSA's decision for RAB

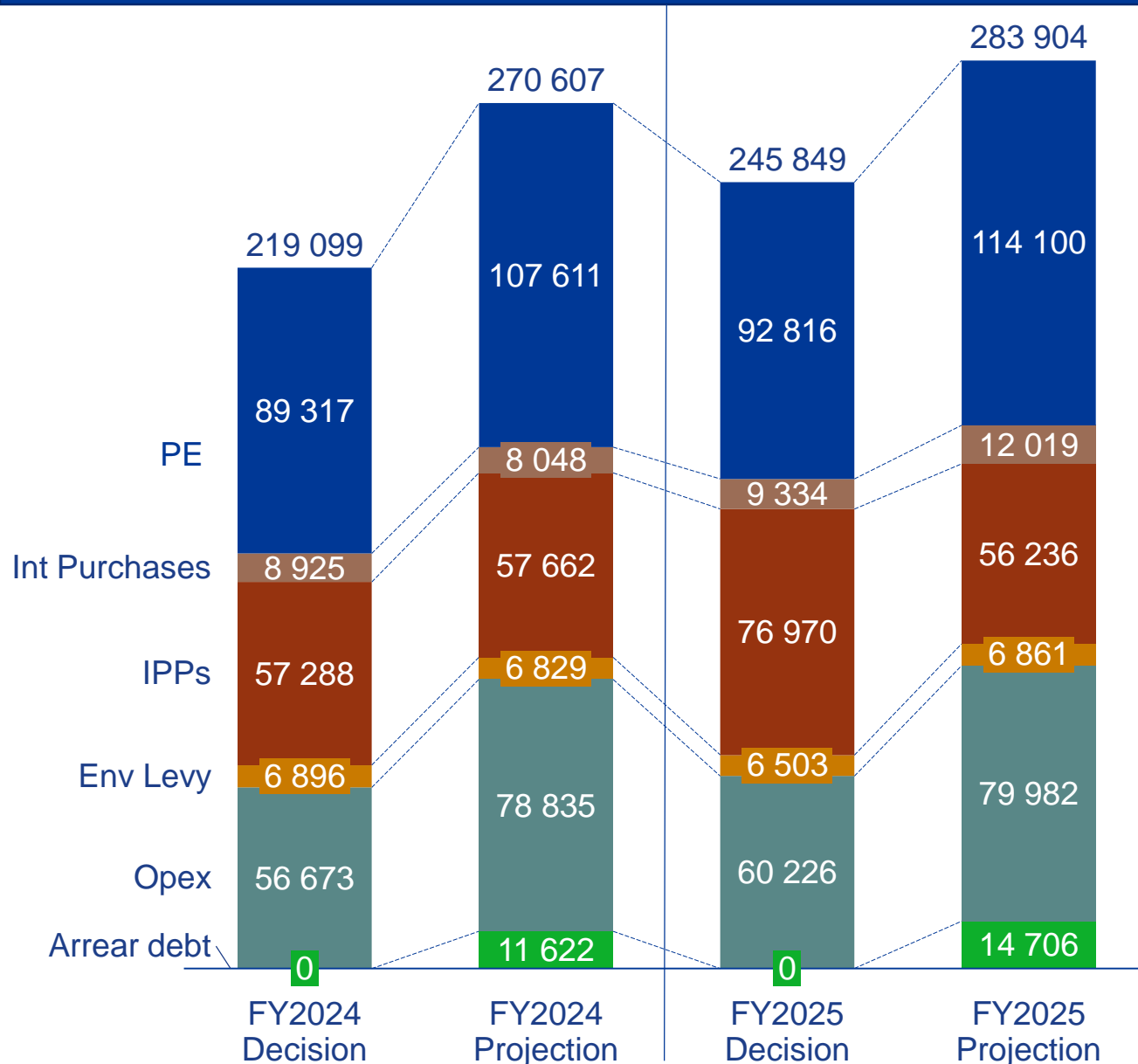


Return on Assets Applied vs Decision (%)



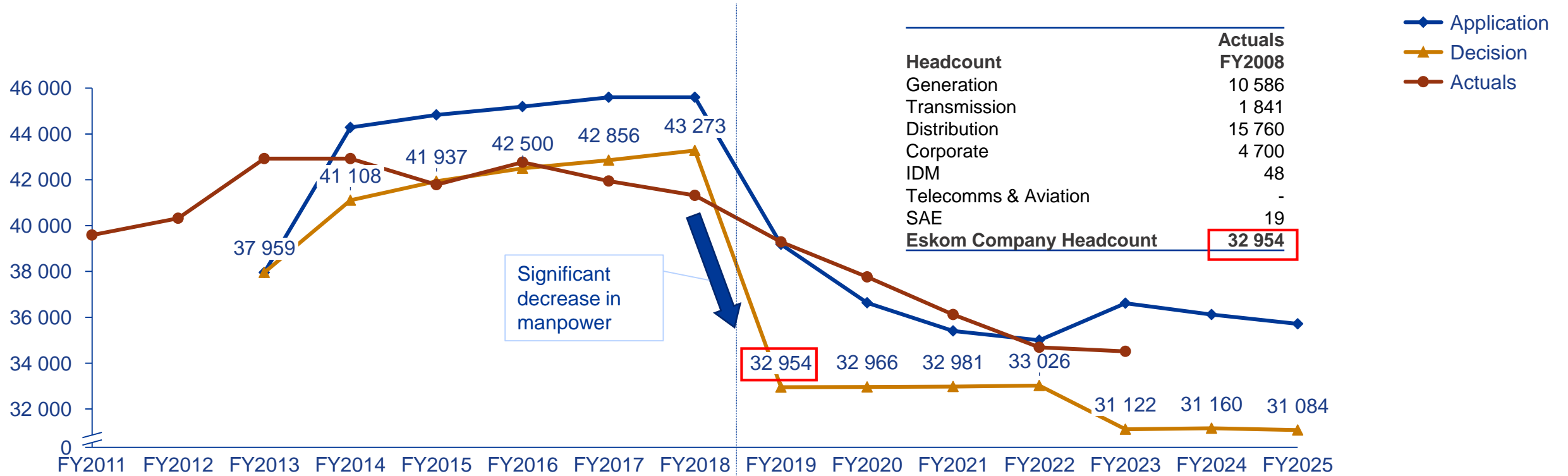
Eskom's average cost of debt far exceeds the return on assets that have been allowed

Spike in FY2026 application due to FY 24 & 25 reality being different compared to the NERSA decision



- ❑ A gap is seen between NERSA decision and realistic projections for FY2024 and 2025
- ❑ Eskom is required to continue to provide electricity to the extent possible – whether NERSA decisions support or not
- ❑ If NERSA’s previous decisions were insufficient – this shortfall requires catch-up in FY 2026
- ❑ Main drivers:
 - Coal**
 - Coal production was 14TWh more than the FY25 NERSA decision to FY25 projection. Filling the gap for IPPs
 - Mining inflation and related cost drivers are different to general inflation
 - Replacement of coal supply from contracts that have ended, or reserves mined out creates a step change in pricing
 - Amortization of capital expenditure for long term agreements where the remaining tenure is now shorter compared to past
 - Start-up gas and oil**
 - Increased utilisation to minimise load shedding
 - Opex**
 - Employee requirements to meet business needs
 - Further maintenance required in accordance operational recovery plan
 - Other opex decision did not cater for operational sustainability
- ❑ **This contributes to the spike for FY 2026 application**

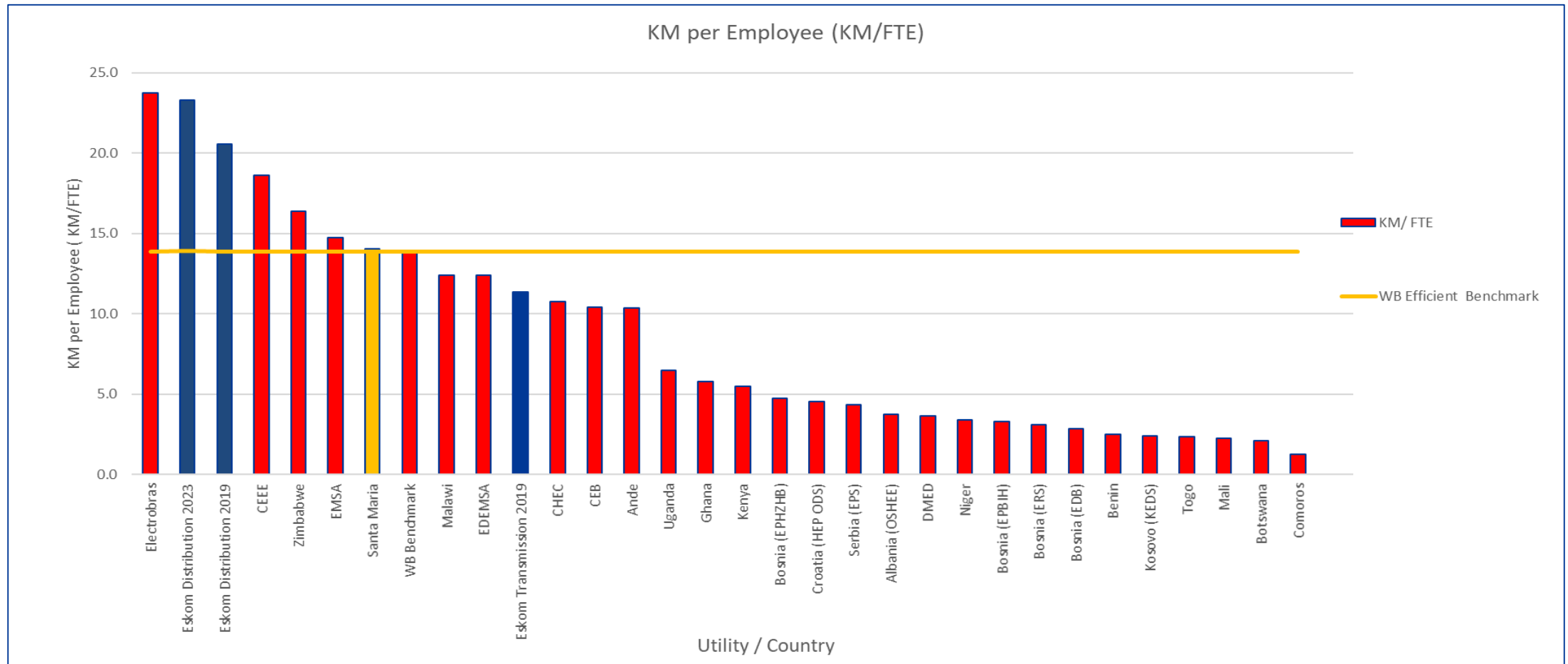
Employee numbers have reduced since over last few years , there is a gap in FY 2023



- Over the MYPD 2 NERSA allowed for employee numbers to increase in line with new build programme
- Over the MYPD 3 this reasoning was maintained for GTD
- However, in this period Eskom restructured to centralised business functions which resulted in an increase in corporate manpower which NERSA did not allow in MYPD 3

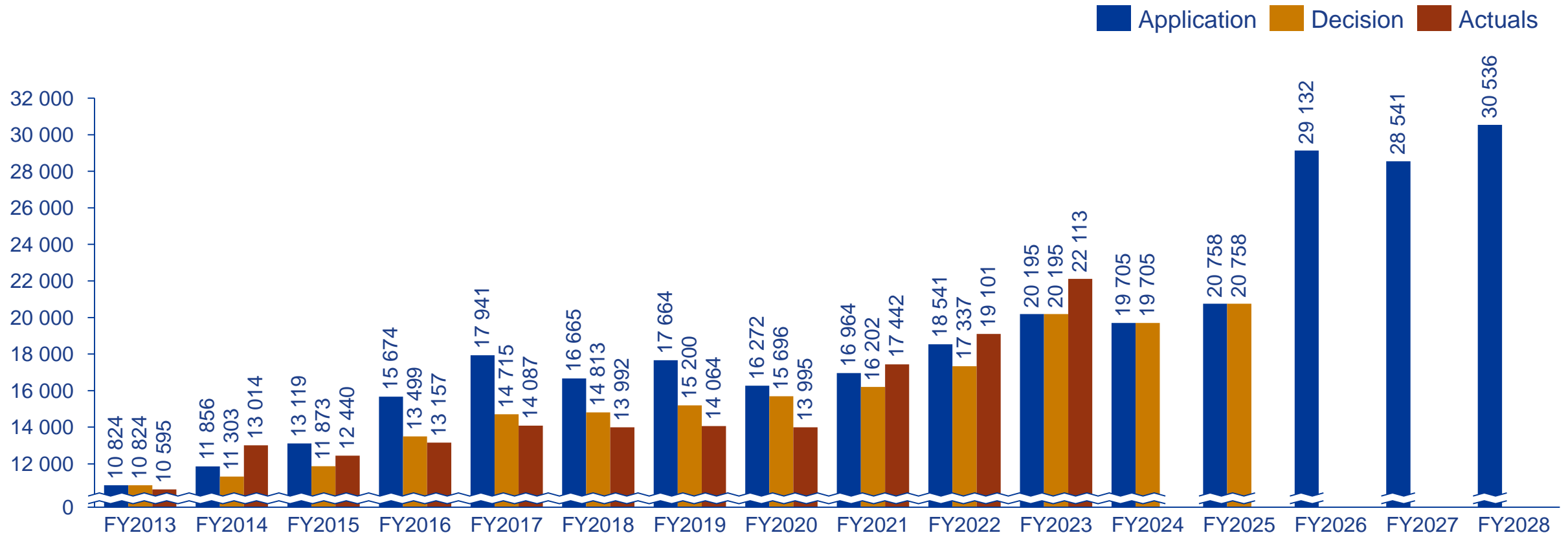
- In the FY2019 decision, NERSA reverted to FY2008 as a basis for assessment on manpower, note this is pre-new build programme
- The significant drop in manpower was unrealistic for Eskom to meet especially considering that these are contracted positions approved in MYPD 3
- Eskom successfully reviewed this in the High Court
- However, subsequently NERSA have maintained a similar outlook on employee numbers and have kept it consistently low

Distribution - International Benchmark



- Eskom Distribution amongst the leanest staffed Distribution utilities in the developing world
- Transmission included for reference only

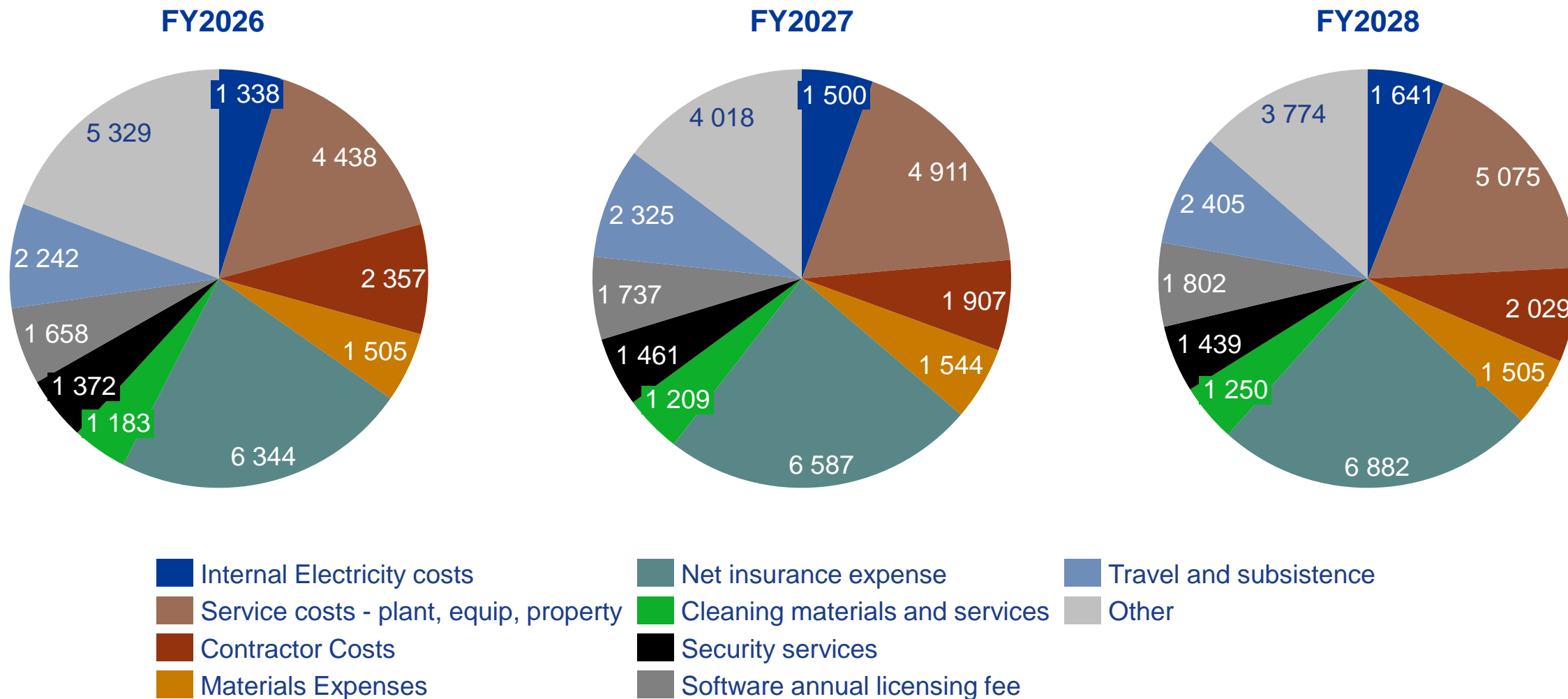
Maintenance is required to sustain operations NERSA has allowed this in their MYPD5 decision



- Further maintenance required in accordance Generation operational recovery plan – 8 priority stations
- Requirement for continued operations –move from shift from “shut down” of older power stations
- More Kusile units operational
- Koeberg long-term outage

Other operating cost split into cost items (Rm)

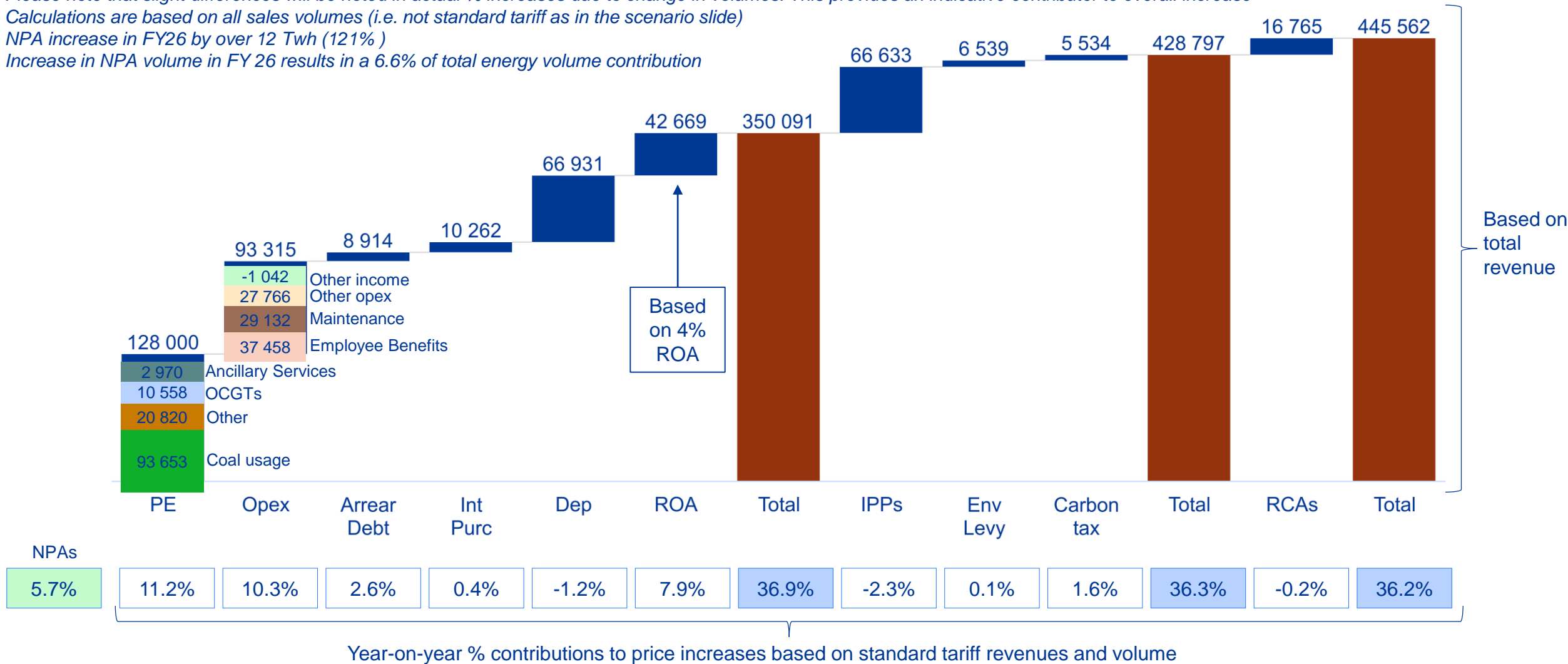
Cost splits are only items that are greater than R1 billion



FY2026 revenue build-up and contributions to total price increase



- The FY26 % increase is in comparison to the FY 25 NERSA decision
- Please note that slight differences will be noted in actual % increases due to change in volumes. This provides an indicative contributor to overall increase
- Calculations are based on all sales volumes (i.e. not standard tariff as in the scenario slide)
- NPA increase in FY26 by over 12 Twh (121%)
- Increase in NPA volume in FY 26 results in a 6.6% of total energy volume contribution

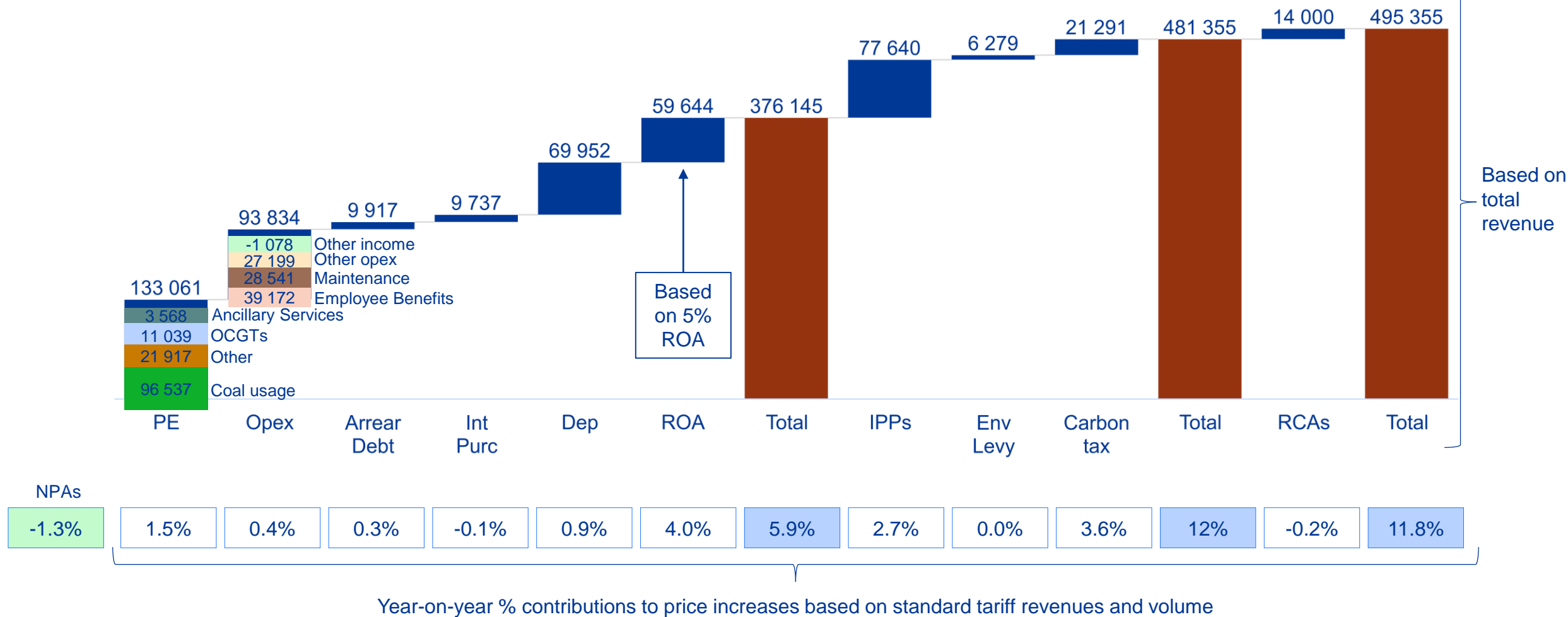


Note: 1) Primary Energy (PE) includes Ancillary Services; 2) Int Purc - International Purchases; 3) Dep - Depreciation 4) ROA - Return on Assets; 5) IPPs - Independent Power Producers; 6) Env Levy - Environmental Levy; 7) RCAs - Regulatory Clearing Account

FY2027 revenue build-up and contributions to total price increase



- The FY27 % increase is in comparison to the FY 26 NERSA decision
- Please note that slight differences will be noted in actual % increases due to change in volumes. This provides an indicative contributor to overall increase
- Calculations are based on all sales volumes (i.e. not standard tariff as in the scenario slide)



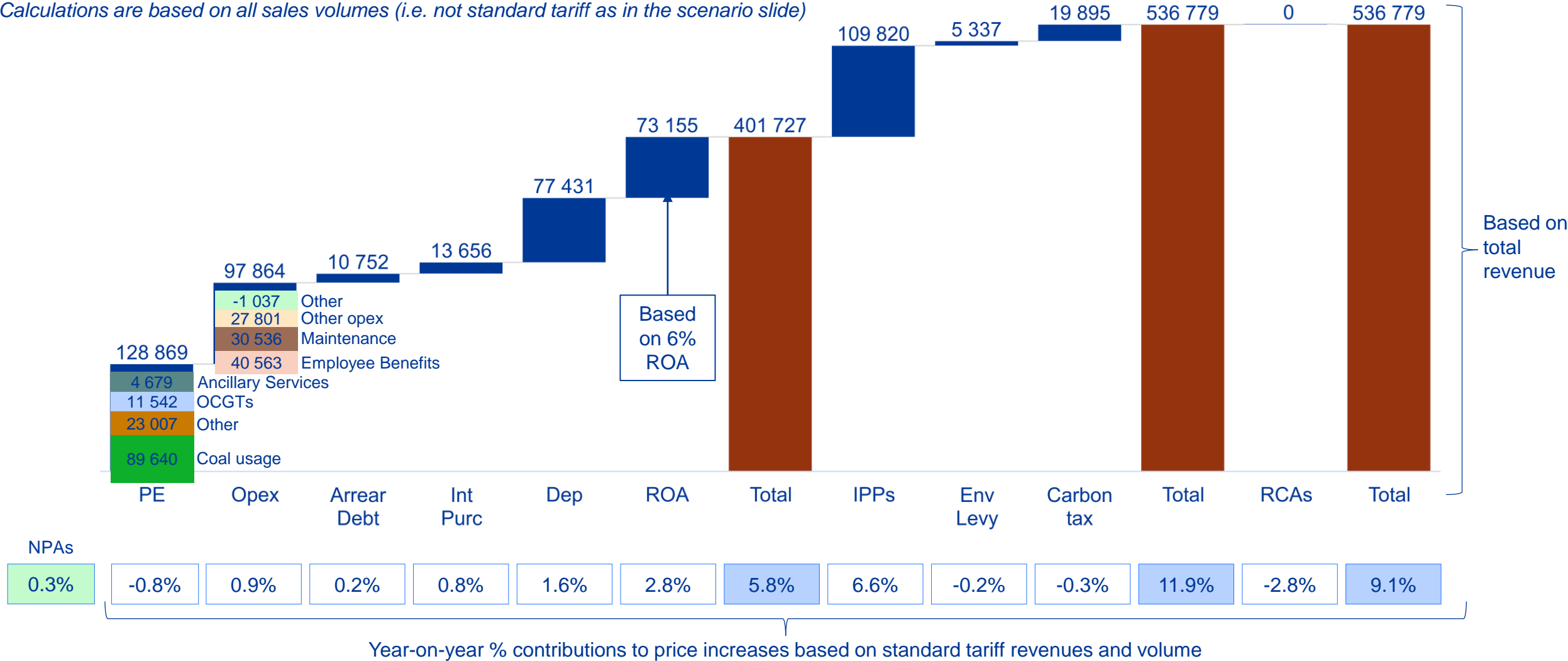
Year-on-year % contributions to price increases based on standard tariff revenues and volume

Note: 1) Primary Energy (PE) includes Ancillary Services; 2) Int Purc - International Purchases; 3) Dep - Depreciation 4) ROA - Return on Assets; 5) IPPs - Independent Power Producers; 6) Env Levy - Environmental Levy; 7) RCAs - Regulatory Clearing Account

FY2028 revenue build-up and contributions to total price increase



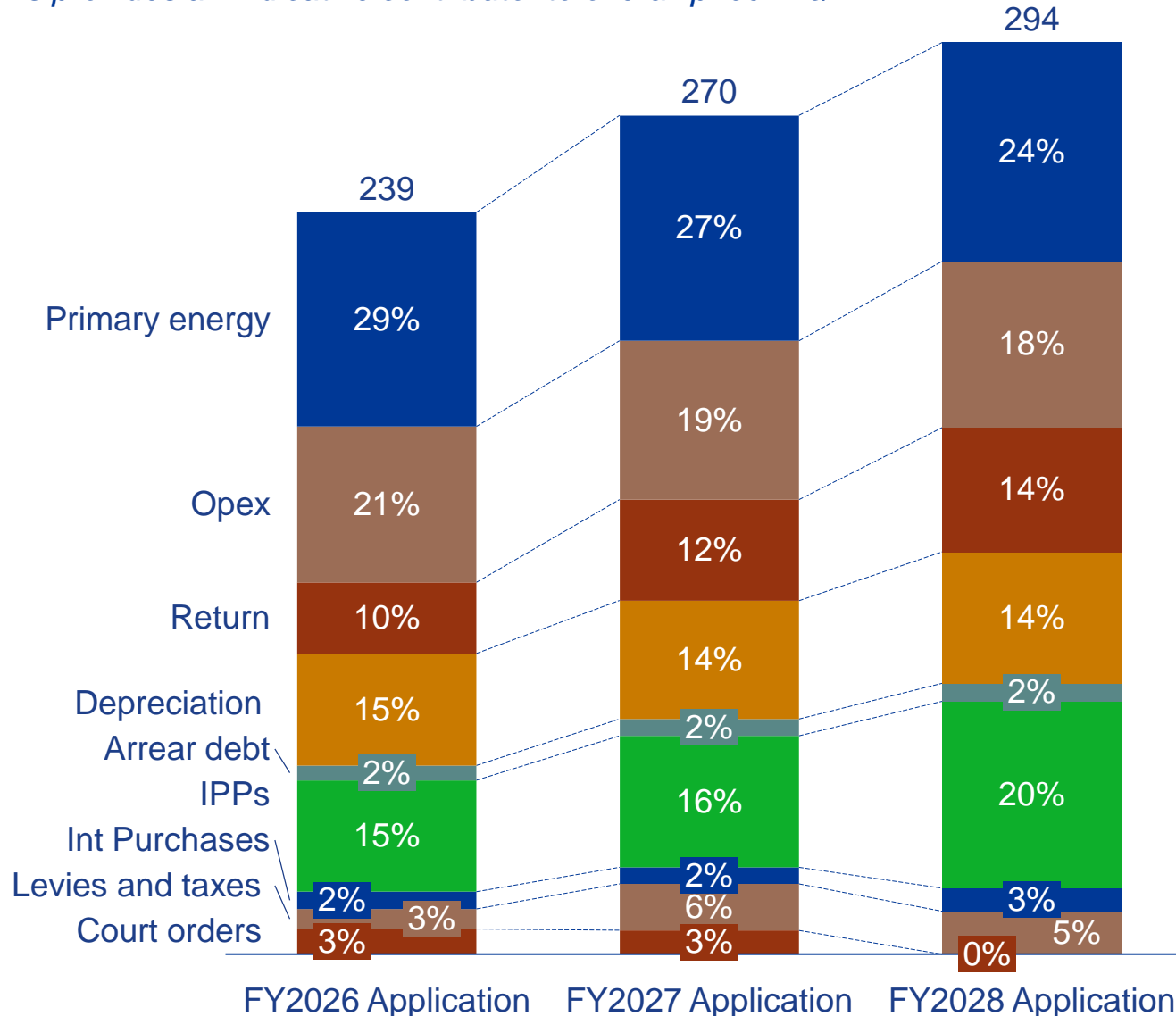
- The FY28 % increase is in comparison to the FY 27 NERSA decision
- Please note that slight differences will be noted in actual % increases due to change in volumes. This provides an indicative contributor to overall increase
- Calculations are based on all sales volumes (i.e. not standard tariff as in the scenario slide)



Note: 1) Primary Energy (PE) includes Ancillary Services; 2) Int Purc - International Purchases; 3) Dep - Depreciation 4) ROA - Return on Assets; 5) IPPs - Independent Power Producers; 6) Env Levy - Environmental Levy; 7) RCAs - Regulatory Clearing Account

Cost contributors to c/kWh and percentage of average tariff

NB: This provides an indicative contributor to overall price in c/kWh



- Eskom management has a role to play in ~50% of the total costs
 - Within the 50% - are many multi-year contracts (prudently undertaken eg coal, employment, maintenance) legislative impacts (regulated diesel, water, fuel oil costs)
- Externally decided costs are:
 - Depreciation - based on NERSA formula
 - ROA - based on NERSA formula and does not reach Eskom WACC
 - IPPs - Govt programme
 - Environmental levy
 - Carbon tax
 - NERSA Court decisions
 - Arrear debt - mainly Munics

- Eskom's application is in accordance with the **2006 Electricity Regulation Act (ERA), Electricity Regulation Amendment Act 38 of 2024 and the prevailing Multi Year Pricing Determination (MYPD) methodology**. It is based on efficient and prudent costs and Return On Assets (ROA) that is increased to allow for cost of capital but still minimising the impact on consumers.
- **Eskom's generators** have again been called upon to **fill the gap** caused by the **unavailability of IPPs** of various technologies
- **Eskom management has a role for about 50% of electricity production costs**, which are mainly contractual and depend on regulated decisions like water and fuel. The other 50% of costs, such as depreciation, Government programmes, and taxes, are externally determined.
- **Eskom's electricity price is lower than in most countries** due to prices not covering the efficient cost of production for providing an electricity service
- Eskom is making a **total revenue application of R446bn, R495bn and R537bn for FY2026, FY2027 and FY2028** respectively
- The key drivers for the Eskom revenue application include:
 - **Enabling the strategic role** played by Eskom
 - Ensuring the **efficient costs and a fair return to Eskom** to continue to provide an electricity service in the form of Generation, Transmission and Distribution services
 - **Migrating towards** recovering an ROA equal to the **weighted average cost of capital**
 - Striving to become self-sufficient and **not continue to be dependent on support from the fiscus**
- For Eskom to be financially viable it needs:
 - Cost reflectivity at revenue and tariff level, balance sheet support by Government, cost exemplarity and collection of billed revenue



Thank you